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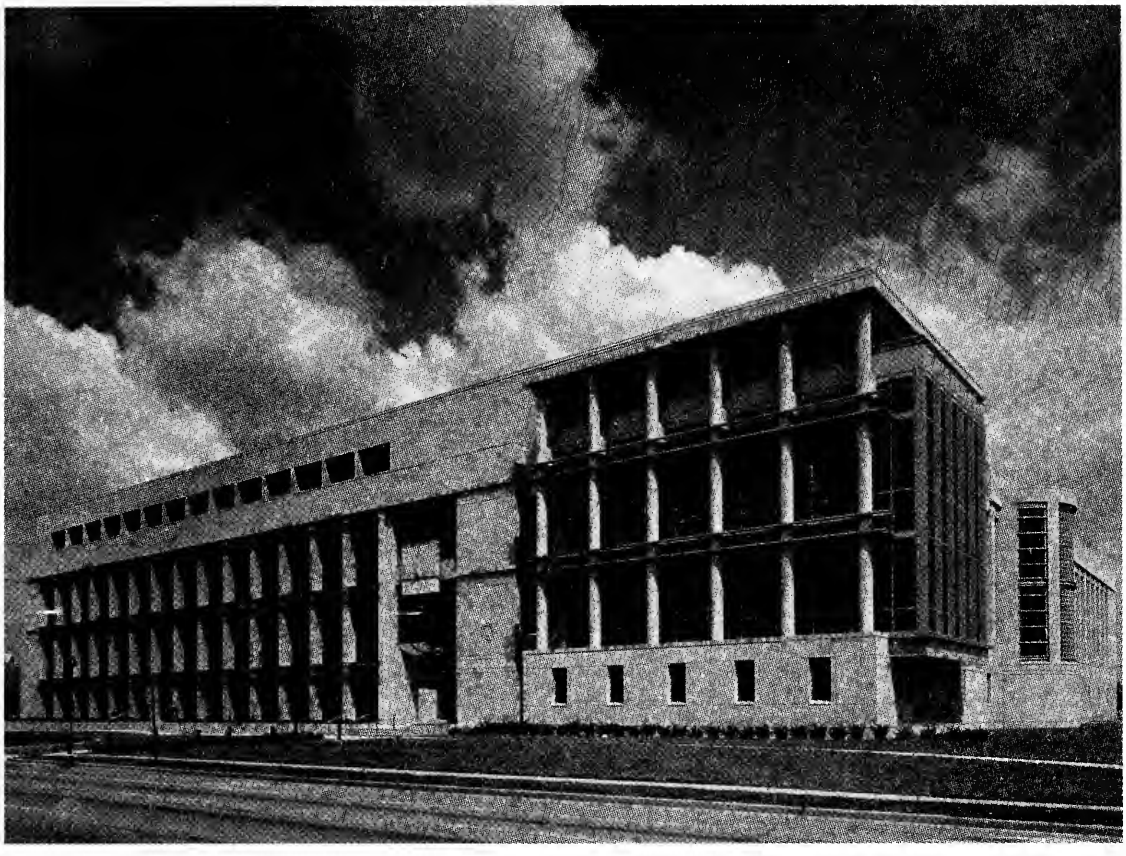

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Volume 39 **2005** **Number 1**

TABLE OF CONTENTS

ARTICLES

NOTES

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ARTICLES

TIES THAT BIND AND RESTRAINTS ON LAWYER COMPETITION: RESTRICTIVE COVENANTS AS CONDITIONS TO THE PAYMENTS OF RETIREMENT BENEFITS*

ROBERT W. HILLMAN**

INTRODUCTION

Client loyalties often run stronger to lawyers than the firms in which their lawyers practice, with the consequence that within a given firm there likely exists a number of lawyers with the ability to leave the firm and take with them revenue streams of some consequence.[1] One of the more dynamic and litigated issues within the growing law of lawyer mobility concerns efforts to restrict contractually future competition by present members of a law firm.[2] For the most part, contractual restraints on competition fall under the clearly articulated ethics codes' bans on bargained practice restrictions following departure from a firm, the *raison d'être* being that clients should have the right to choose the lawyers who will represent them.[3]

There exists one important, but largely undeveloped, exception to the ethics codes' ban on restrictive covenants. Both the Model Code of Professional Responsibility[4] and the more recent Model Rules of Professional Conduct exempt from their anticompetition bans an agreement tying noncompetition to benefits paid on account of retirement.[5] The retirement benefits exception is important because the departure of a partner from a law firm typically will prompt some

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** Fair Business Practices Distinguished Professor of Law, University of California, Davis. My thanks to Stephanie Brooks for her excellent research assistance.

1. *See generally* Robert W. Hillman, *Law Firms and Their Partners: The Law and Ethics of Grabbing and Leaving*, 67 TEX. L. REV. 1 (1988).

2. *See generally* ROBERT W. HILLMAN, HILLMAN ON LAWYER MOBILITY § 2.3.5 (Supp. 2005).

3. *See id.* § 2.3.3.

4. *See* MODEL CODE OF PROF'L RESPONSIBILITY DR 2-108(A) (1980) ("A lawyer shall not be a party to or participate in [a covenant not to compete], except as a condition to payment of retirement benefits.").

5. *See* MODEL RULES OF PROF'L CONDUCT R. 5.6 (2005) ("A lawyer shall not participate in offering or making [a covenant not to compete], except an agreement concerning benefits upon retirement.").

type of payout in satisfaction of the lawyer's interest in the firm. To the extent that firms are able to categorize the payouts as retirement benefits, they have an effective means of protecting their client base by preventing competition from lawyers to whom client loyalties may run deeply.

The ethics codes are bereft of anything resembling legislative history, and the policy justification for linking retirement payments with a noncompetition commitment is not entirely clear.[6] The lack of a definition for "retirement" heightens the interpretive challenges posed by the retirement benefit exception. The nearly blank tablet offered by the codes has left courts with the task of articulating a framework for identifying the range of contractual restraints on competition that may fall within the retirement benefits exception. This Article considers the developing law on the point and offers a framework for distinguishing impermissible restraints on competition from allowable retirement benefits conditioned on noncompetition.[7]

I. A PRELIMINARY NOTE ON PARTNERSHIP PAYOUTS

Law firm partners are equity participants in an economic enterprise.[8] Often, but not always, partners purchase their interests upon becoming partners or through subsequent capital contributions.[9] The value of a given partner's interest may be more or less than any amount the partner paid for the interest and may fluctuate with each accounting cycle. When a partner's association with a firm ends, either by death, withdrawal, or discharge, the partnership agreement typically will provide a method and formula for settling the account of the former

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6. The ethics codes' ban on restrictive covenants dates to the Model Code's appearance in 1969. From the beginning the prohibition has included an exception for the payment of retirement benefits. In the decade preceding the appearance of the Model Code, ethics opinions signaled uneasiness with contractual restraints on competition. *See, e.g.*, ABA Comm. on Ethics and Prof'l Responsibility, Informal Op. 1072 (1968) (finding that law partners cannot enter into restrictive covenants); ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 300 (1961) (declaring improper an anticompetition covenant in an associate's employment contract).

7. The analysis builds on a framework outlined in HILLMAN, *supra* note 2, § 2.3.5, initially proposed in the predecessor edition to the present treatise. *See* ROBERT W. HILLMAN, LAW FIRM BREAKUPS: THE LAW AND ETHICS OF GRABBING AND LEAVING § 2.3.4 (1991 Supp.). The framework has been applied by some courts. *See, e.g.*, Neuman v. Akman, 715 A.2d 127, 135-36 (D.C. 1998); Donnelly v. Brown, Winick, Graves, Gross, Baskerville, Schoenebaum, & Walker, P.L.C., 599 N.W.2d 677, 682 (Iowa 1999) (Ternus, J., concurring); Borteck v. Riker, Danzig, Scherer, Hyland & Perretti LLP, 844 A.2d 521, 528-29 (N.J. 2004).

8. This statement assumes that the label "partner" is employed correctly. For a discussion of nonequity partners in law firms, see Robert W. Hillman, *Law, Culture and the Lore of Partnership: Of Entrepreneurs, Accountability and the Evolving Status of Partners*, 40 WAKE FOREST L. REV. 793 (2005).

9. In this Article, "partner" is used in the broadest sense to include any equity stakeholder in a firm, whether the firm is a partnership, a professional corporation, a limited liability company, or some other form of association.

partner. The payment may be a single lump sum or installments over a period of time and may consist of both a return of the capital invested by the former partner in the firm as well as some element of profit or enhanced value on this sum.

The payout methodology is important to both the firm and the recipient's former partners.[10] Firms commonly pay departing partners a "return of capital,"[11] with payments ranging from a few thousand dollars to several hundred thousand dollars made in installments over periods ranging from three to sixty months.[12] Goodwill often is not included in payout amounts.[13] Payouts are a function of bargaining, however, and some partnership agreements provide for payments to departing partners well in excess of the balances in their capital accounts. Such contractual provisions may serve to encourage lateral departures and subsidize competition by former firm members. When this occurs, the contracts have the operative effect of destabilizing firms.

Beyond the normal withdrawal payments, partners, like employees, may enjoy payouts grounded in funded and qualified retirement plans offering significant tax benefits conditioned on broad-based participation. Qualified plans, however, cannot discriminate in favor of highly compensated employees (i.e., partners). Nonqualified plans may discriminate and are a popular means of structuring deferred compensation for partners of professional services firms. Altman Weil surveys reveal that a substantial but declining minority of law firms have nonqualified plans providing payouts to partners upon their withdrawals from the firms; the larger the firm, the more likely it is that some form of such a plan exists.[14]

> The historical law firm retirement "plan" had been an income stream for life for retired partners. The modern traditional non-qualified plan consisted of a return of capital and an interest in unbilled time and accounts receivable (essentially an accrual basis buy-out as opposed to an income stream for retirement). Today, firms with unfunded plans often use a percentage of past earnings as the primary determinant of entitlement, in addition to a return of cash basis capital.

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10. Payment in settlement of a departing partner's account distinguishes the partner from an employee. Although the employee may have helped build value in the firm, her claim on firm assets normally is limited to salary paid for services rendered.

11. In the case of a professional corporation, the capital repurchase would be accomplished through a stock buyback, with the capital return comprising all or a portion of the purchase price.

12. *See* Altman Weil, Inc., Retirement and Withdrawal Survey for Private Law Firms 6 (2005 ed.) [hereinafter Altman Weil 2005 Survey].

13. *Id.* The assumption here is that firm goodwill is minimal or nonexistent because clients have greater loyalties to individual attorneys than to the firms in which the attorneys practice. For a discussion of efforts to enhance firm goodwill, see HILLMAN, *supra* note 2, § 2.5.2.

14. Altman Weil 2005 Survey, *supra* note 12, at 88. The twenty-four percent of firms maintaining such plans represents a decline from the twenty-eight percent reported three years earlier. *See* Altman Weil, Inc., Retirement and Withdrawal Survey for Private Law Firms 32 (2002) [hereinafter Altman Weil 2002 Survey].

> . . .
> These plans are represented by unsecured promises.[15]

The nonqualified plans typically are not pre-funded, which means that payments are dependent upon future income streams of the firm.[16] Significantly, about one-third of firms surveyed pay benefits only to individuals who retire from the practice of law.[17]

For present purposes, the important characteristic of a nonqualified plan is its similarity to more generalized arrangements for payouts to departing partners. In fact, it may be difficult, if not impossible in some cases, to distinguish clearly the retirement payout from the payout in settlement of a partner's interest. To the extent that the label controls the analysis, firms have an incentive to denominate a large portion of payouts as retirement benefits in order to subject such payments to possible forfeiture in the event of competition by the former partner.

II. PAYOUTS AS COMPETITION SUBSIDIES

Although economic disincentives to competition by former law partners generally are not enforced, courts often acknowledge the difficulty of striking a proper balance between the interest of clients in enjoying unfettered choice among lawyers and the interest of firms in limiting payments to individuals who depart, compete, and potentially undermine the very income stream used to fund the payments. One of the more candid discussions of the point is found in a New Jersey Supreme Court opinion that voided a partnership agreement's clause requiring a forfeiture of payouts in the event of competition:

> [W]e recognize that if a partner's departure will result in a decrease in the probability of a client's return and a consequent decrease in prospective earnings, that departure may decrease the value of the firm's goodwill. It would not be inappropriate therefore for law partners to take that specific effect into account in determining the shares due a departing partner.[18]

Accordingly, while forfeiture of the capital account for the reason of competition may never be permitted, other components of a payout reflecting the former partner's interest in the firm's future income stream may be offset by the

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15. Altman Weil 2005 Survey, *supra* note 12, at 12.

16. *Id.* at 114. However, the percentage of firms prefunding their plans has increased to thirty-five percent from the thirteen percent reported in 2002. *See* Altman Weil 2002 Survey, *supra* note 14, at 56.

17. *See* Altman Weil 2005 Survey, *supra* note 12, at 94. Interestingly, an earlier survey revealed that nearly two-thirds of firms limit benefits by noncompetition clauses. *See* Altman Weil 2002 Survey, *supra* note 14, at 35. The question was removed from the 2005 Survey because of a poor response rate in the earlier survey, which calls into question the reliability of the 2002 data on these noncompetition clauses.

18. Jacob v. Norris, McLaughlin & Marcus, 607 A.2d 142, 152 (N.J. 1992).

diminution of the income stream attributable to the partner's departure.[19] Although the logic of the reasoning cannot be disputed, the difficulty lies in crafting a buyout adjustment that reflects or even approximates the effect of the partner's departure. At least to date, only a handful of forfeiture clauses have survived challenges.[20]

III. WHY DISTINGUISH RETIREMENT?

One obstacle to interpreting the retirement payment exception to the ban on restrictive covenants is the absence of an articulated policy supporting the exception.

The principal justification for allowing restraints on competition by retiring partners lies in the concern over the use of a firm's income streams to support competition with the firm. To discourage departures and to avoid subsidizing competition that may itself affect income streams, a rational firm will seek to minimize payouts to departing partners, perhaps limiting such amounts to the return of capital the partners previously invested in their firm. Such a limited payout applied across-the-board to all departing partners would be unobjectionable under ethics norms.[21]

The ethics problem arises not from limited payouts but from differential payouts that are reduced because of competition. By altogether limiting or prohibiting forfeitures for competition, the ethics norms promote a more vibrant market for legal services that operates to the benefit of the consumers of those services. Under these circumstances, it is to be expected that firms will tend to provide lower rather than higher payouts to all partners, applied without regard to anticipated or actual competitive activities.

This, of course, ignores the special circumstance of retirement. An attorney's retirement may serve the interests of the firm as well as the individual. This is especially true when the individual claims an amount of the firm's present income that exceeds the revenues associated with the lawyer's practice. In the past era of lockstep compensation,[22] the period in which the present restrictions on forfeiture for competition were framed, the retirement of senior lawyers (or more

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19. *See id.*

20. *See generally* HILLMAN, *supra* note 2, § 2.3.4.

21. However, if a distinction is drawn between ordinary withdrawals that trigger forfeitures and retirements that do not, the effect may be to discourage competition, and enforcement of the agreement becomes problematic. For example, in *Fearnow v. Ridenour, Swenson, Cleere & Evans, P.C.*, 110 P.3d 357, 358 (Ariz. Ct. App. 2005), a law firm's stockholder agreement provided that a lawyer who withdrew from the firm for reasons other than retirement "shall tender his or her [s]hare to the Corporation for no compensation." This was an especially harsh provision in that the forfeiture it triggered included a partner's capital investment in the firm. Not surprisingly, the court had little trouble voiding the clause. *Id.* at 360.

22. Lockstep compensation plans generally allocate profits on the basis of seniority, so that a lawyer who remains with a firm may expect a progressively greater share of profits with each passing year.

bluntly, "pushing out the old") was a critical step in moderating the distortions inherent in seniority-based compensation schemes.[23] For this reason, it is no surprise that an allowance for contractual restraints on competition in the case of retirement benefits became an important exception to the general prohibition on competition restraints.

Over the last several decades, trends in lawyer mobility have correlated with widespread abandonment of lockstep compensation systems.[24] The demise of compensation systems skewed in favor of those with seniority diminishes the need for a firm to have a rational exit plan (i.e., a retirement plan) for more highly compensated senior partners. Through reductions in compensation, demotions, and even expulsions, firms have adopted alternatives to retirement for addressing the declining productivity of aging partners.[25]

Moreover, the growth of lateral movement by lawyers among firms means that many lawyers do not remain with firms for large portions of their professional lives. In an environment of lawyer mobility, one would expect firms to limit their financial commitments to former partners. This may explain the apparent decline in nonqualified deferred compensation plans, and even when such plans are continued, it is common to see changes reducing benefits and imposing longer vesting schedules.[26] From a longer term perspective, the trend would suggest the need for greater portability in retirement benefits, although it is doubtful that the argument for such a change is any stronger for lawyers than it is for other participants in the workforce.[27]

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23. The "pushing out the old" concept has deep roots in labor and the development of the retirement model. *See, e.g.*, DORA L. COSTA, THE EVOLUTION OF RETIREMENT: AN AMERICAN ECONOMIC HISTORY 1880-1990, at 21-25 (1998).

24. The 1980s marked the transition to a period of lawyer mobility. In 1987, Chief Justice Rehnquist noted the change: "Institutional loyalty appears to be in decline. Partners in law firms have become increasingly 'mobile,' feeling much freer than they formerly did and having much greater opportunity than they formerly did, to shift from one firm to another and take revenue-producing clients with them." William H. Rehnquist, *The Legal Profession Today*, 62 IND. L.J. 151, 152 (1987). By the mid-1990s, the trend of enhanced lawyer mobility was sufficiently established that the New York Court of Appeals noted that the "revolving door" is a "modern-day law firm fixture." Graubard Mollen Dannett & Horowitz v. Moskovitz, 653 N.E.2d 1179, 1180 (N.Y. 1995). And with the turn of the century came a website, www.lateralattorneys.com, that openly solicited "partners with portables" and offered to "assist entire practice groups in relocating to new firms." Law Firm Mergers/Partners with Portables, http://www.lateralattorneys.com/attorneyjobs/partners.asp (last visited Nov. 17, 2005). The present site is somewhat more subdued in emphasizing individual lawyer and paralegal mobility rather than the movement of practice groups.

25. *See* Robert W. Hillman, *The Bargain in the Firm: Partnership Law, Corporate Law, and Private Ordering Within Closely-Held Business Associations*, 2005 U. ILL. L. REV. 171 (2005).

26. *See* Altman Weil 2005 Survey, *supra* note 12, at 10.

27. For a discussion of trends in pension portability, see JOHN TURNER, AARP PUB. POL'Y INST., PENSION PORTABILITY—IS THIS EUROPE'S FUTURE? AN ANALYSIS OF THE UNITED STATES AS A TEST CASE (2003), *available at* http://assets.aarp.org/rgcenter/econ/2003_03_pension.pdf.

IV. RETIREMENT TRENDS

For nearly a century, society has assumed an individual with a normal lifespan will reach a point at which he or she will withdraw from the workforce (i.e., retire). Earlier conceptions of retirement assumed the withdrawal would be complete, while more contemporary assumptions may depart from this linear model and involve somewhat greater professional and work activity during the retirement period. In either event, retirement for a lawyer marks withdrawal from practice, a substantial change in the nature of practice, or a meaningful reduction in the amount of time committed to practice.

Studies have demonstrated that within the labor force leisure is an increasingly important motivation for retirement.[28] There seems little reason to suggest that lawyers have a different view of what it means to retire. Viewed in this light, allowing contractual restraints on competition when payments are keyed to retirement is consistent with the larger assumption that individuals often retire because they choose leisure over work. The inference to be drawn from this assumption is that retirement does not occur when a lawyer simply transports a practice from one firm to another.[29]

Although the desire for increased leisure may motivate retirement, one of the most significant trends in retirement is the continuation by retired individuals of some work or professional activities. Although fifty percent of U.S. workers officially retire by age sixty, only eleven percent fully retire by that time.[30] The reasons for work activities after retirement range from the economic (especially lifestyle considerations and a reluctance to lower the previous standard of living) to the desire to remain active in a work-related environment.[31] Whatever the motivation, past assumptions that equate retirement with idleness may no longer hold. The change is of some importance when applying a standard premised on a simple and aged model of retirement as a cessation of work.

Portability is more readily achieved with funded defined contribution plans, which are based on individual account balances rather than a formula that defines the payout.

28. *See generally* COSTA, *supra* note 23, at 133-54 (discussing trends in leisure consumption).

29. *Cf.* D.C. Bar Legal Ethics Comm. Op. 325 (2004) ("The exception in Rule 5.6(a) for an agreement relating to benefits upon retirement applies only to the type of retirement typical at the end of a career and not to all departures from a firm.").

30. *See* Seongsu Kim & Daniel C. Feldman, *Working in Retirement: The Antecedents of Bridge Employment and Its Consequences for the Quality of Life in Retirement*, 43 ACAD. MGMT. J. 1195 (2000). Moreover, retirees with a high degree of career identification are more likely than others to engage in work or professional activities subsequent to retirement. *Id.*

31. Gender differences are noteworthy. Older women on average seek to work fewer hours than men of comparable ages, but more educated women tend to work until older ages. *See* Elizabeth T. Hill, *The Labor Force Participation of Older Women: Retired? Working? Both?*, 125 MONTHLY LAB. REV. 39 (2002). Men tend to have more orderly career paths than women, and this has been found to contribute to the earlier retirement of men. *See* Shin-Kap Han & Phyllis Moen, *Clocking Out: Temporal Patterning of Retirement*, 105 AM. J. SOC. 91 (1999).

V. THE PARAMETERS OF RETIREMENT

Because the ethics codes explicitly exempt retirement benefit payments from the general ban on restrictive covenants, considerable importance attaches to the rather straightforward inquiry of what, exactly, does "retirement" mean?

As noted above, neither the Model Code nor the Model Rules attempts to define the term, which creates an ambiguity that those desiring to employ contractual restraints on competition may choose to exploit. Viewed most broadly, retirement may be synonymous with withdrawal, such that any partner leaving a firm may be said to be retiring from the firm. Such a reading was rejected in one of the earlier cases on the retirement benefits exception, where the court quite properly remarked that if withdrawal is the same as retirement "then the disciplinary rule has no meaning."[32] That perceptive point made, the court failed to give additional guidance on defining retirement benefits.

An early and significant judicial analysis of retirement benefits is *Cohen v. Lord, Day & Lord*,[33] a landmark case on lawyer mobility. *Cohen*'s principal significance is its conclusion that the ethics prohibition on restrictive covenants extends to contractual provisions imposing a monetary penalty on withdrawing partners who subsequently compete with their former firms.[34] Importantly, it rejected the law firm's attempt to bring the contractual forfeiture within the retirement benefits exception, offering three distinct reasons in support of this result: (1) a different and mutually exclusive section of the partnership agreement specifically provided for retirement benefits; (2) retirement benefits typically extend to the death of the retiring partner, while the departure compensation at issue in the case was paid only over a three year period; and (3) treating "departure compensation as a retirement benefit would invert the exception into the general rule, thus significantly undermining the prohibition against restraints on lawyers practicing law."[35]

Although the existence of distinct, mutually exclusive provisions concerning departure compensation and retirement benefits is a reason not to treat departure compensation as a retirement benefit, placing undue emphasis on such provisions may prompt an adroit drafter to merge the provisions into an integrated provision of the partnership agreement. *Cohen* was correct in observing that to treat all departure compensation as retirement benefits would undermine severely the ban on restrictive covenants,[36] but that point does little to develop a framework for distinguishing payments triggered by withdrawal that qualify as retirement benefits from those that do not.

The most meaningful and specific guidance offered in the opinion for defining "retirement" benefits that may be subject to forfeiture for competition

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32. Gray v. Martin, 663 P.2d 1285, 1290 (Or. Ct. App. 1983).
33. 550 N.E.2d 410 (N.Y. 1989).
34. *Id.* at 412. *See generally* HILLMAN, *supra* note 2, § 2.3.
35. *Cohen*, 550 N.E.2d at 412.
36. *Id.*

is the temporal notion that retirement benefits "extend to the death of the retiring partner and then may even continue to the partner's surviving spouse,"[37] while the departure payments under the agreement at issue ended after three years. Some retirement plans do indeed provide for payments over the life of the recipient, but many do not. A large number of retirement plans provide for lump-sum or installment payments, and it is unclear what policy consideration is advanced by concluding that a short pay-out period for benefits removes the payments from the retirement exception.

VI. A SUGGESTED FRAMEWORK FOR APPLYING THE RETIREMENT BENEFITS EXCEPTION

Inasmuch as restrictive covenants are permissible when tied to the payment of retirement benefits, it is important to focus on the purpose of an agreement establishing the right to departure payments as a first step in determining whether a forfeiture-for-competition provision *unduly* impedes the ability of clients to choose their lawyers.

An agreement may provide for post-withdrawal payments for any one of a number of reasons. Some agreements merely reiterate the partnership law's winding-up provisions and set forth the method by which a withdrawing partner will share in income generated from work in process at the time of withdrawal.[38] Other agreements, such as the one at issue in *Cohen*, attempt to modify the default provisions of partnership law by setting forth an alternative mechanism for the sharing of post-withdrawal income. And still other agreements seek to terminate the right of any withdrawing partner to share in post-withdrawal income and provide only for departure payments calculated with reference to the partner's capital account.

Each of the types of agreements described above provides a method of terminating a partner's interest in unfinished business or settling the account of a withdrawing partner. Account-settlement agreements are to be distinguished from agreements recognizing that some partners, upon reaching a certain age, will cease practicing law and as a result suffer a substantial drop in income. Only this latter type of agreement pertains to "retirement" as that term is customarily used. Furthermore, it is only the benefits that are payable pursuant to such agreements that fit comfortably within the retirement exception to the ban on restrictive covenants. When a partner "retires" and then proceeds to compete with the firm, the premise upon which retirement benefits have been based is undermined.

There remains the problem of distinguishing forfeiture-for-competition clauses relating to true retirement benefits from those relating to other types of departure payments, principally account settlement arrangements. Because those who desire to draft enforceable restrictive covenants have every incentive to cast payments forfeited by virtue of competition as retirement benefits, the task of

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37. *Id.*

38. The default provisions of partnership law provide for sharing of income from work in process at the time of a withdrawal. *See generally* HILLMAN, *supra* note 2, § 4.6.

making the distinction is difficult. Nevertheless, a number of criteria may be useful in evaluating whether the retirement exception is available. These include: (1) the presence of minimum age and service conditions; (2) the existence of distinct withdrawal provisions governing non-retirement payouts; (3) the payment of benefits over an extended period of time; and (4) the payment or availability of ancillary benefits (primarily insurance and staff support). The criteria are discussed below, as is the issue of whether the nature of payments as "retirement" benefits should be dependent upon the sources from which they are derived.

A. The Factors

1. Minimum Age and Service Conditions.—Perhaps the most important distinguishing characteristics of retirement benefits are minimum age and service requirements. Payments made without regard to a partner's age and length of association can hardly be denominated payments for that partner's "retirement."[39] Moreover, a relatively modest service condition without a minimum age requirement should be viewed as suspect because of the unlikelihood that substantially all partners who leave the firm after satisfying the service condition will indeed be withdrawing for the purpose of retirement (that is, cessation of the practice of law).

2. The Existence of Separate Withdrawal Provisions.—Another factor relevant in evaluating whether departure payments are retirement benefits is the existence of provisions dealing independently with withdrawal for purposes of retirement and withdrawal for other reasons. *Cohen* treated the existence of "mutually exclusive" provisions dealing with withdrawal for purposes of retirement and withdrawal for other purposes as evidence that the latter is distinct from the former.[40] As noted, this represents an invitation to the clever drafter of partnership agreements to expand the range of withdrawals for retirement and to attempt to restrict (or even eliminate) the range of withdrawals for other purposes. The existence of independent and substantial provisions covering retirement and nonretirement withdrawals, on the other hand, does give credence to the argument that the provisions dealing with retirement may indeed have been designed for the purpose suggested by their label.

3. Period Over Which Payments Are Made.—The period over which the payments are to be made is relevant, although not dispositive. As noted, the *Cohen* court's assumption that retirement payments generally extend over the life of the recipient is incorrect; many retirement plans permit lump-sum or installment payments. Although the fact that payments are made over a relatively short period of time should not defeat their classification as retirement benefits, payment over an extended period supports the conclusion that they are for

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39. *Cf.* Miller v. Foulston, Siefkin, Powers & Eberhardt, 790 P.2d 404, 413 (Kan. 1990) (upholding a partnership agreement provision precluding the withdrawing attorney who received retirement benefits from practicing law because of the requirement that eligibility for retirement was conditioned on a minimum age (sixty) or period of service (thirty years)).

40. *Cohen*, 550 N.E.2d at 412.

funding a retirement.

4. Availability of Ancillary Benefits.—Firms commonly provide ancillary benefits to retired partners. These benefits may include life insurance, health insurance, and office and staff support.[41] The presence of one or more of such benefits would support the conclusion that a partner has "retired" and payouts may be conditioned on noncompetition. The absence of all ancillary benefits does not necessarily dictate a contrary result, but it is contrary to the norm for retired partners. Therefore, it may create a presumption that payouts are not made for the purpose of funding retirement (and so may not be tied to noncompetition).

B. The Funding Question

A small but growing body of authority distinguishes benefits funded by the recipient partner from benefits funded by the firm in assessing whether forfeitures for competition by retired partners are permissible. A Virginia ethics opinion draws this distinction in concluding that only benefits funded by the firm or a third party (as opposed to deferred compensation previously earned by a partner) qualify as retirement benefits forfeitable because of competition.[42] The letter from the chair of the ethics committee to the firm requesting the opinion explained:

> It is our opinion that a plan containing a clause which would prohibit a lawyer from withdrawing compensation already earned in the event that attorney engaged in the practice of law in a geographically competitive radius to his old firm, would be in violation of the Disciplinary Rule, but only to the extent that the plan involved deferred compensation . . . . To the extent that the benefits from such a plan came from funding by the employer corporation or partnership or third parties, then the exception to the basic rule should prevail and the restriction on the right to practice within a "reasonable radius" should be acceptable.[43]

The Virginia ethics opinion was noted by the District of Columbia Court of Appeals in *Neuman v. Akman*,[44] which distinguished a "deferred payout of a current asset"[45] from a retirement benefit:

> Under the partnership agreement, Neuman will recover his capital account and his "share of net profits of the partnership for the portion of the fiscal year of retirement ending on the date of retirement" regardless

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41. *See* Altman Weil 2005 Survey, *supra* note 12, at 46-47. Among firms of all sizes, a majority provide retired partners with health insurance (sixty percent) and office and staff support (seventy-nine percent), while a minority provide retired partners with life insurance (thirty-one percent). *Id.* at 46.

42. *See* Letter from Colin J.S. Thomas, Jr., Chairman, Standing Comm. on Legal Ethics at the Va. State Bar, Op. 880 (Mar. 11, 1987) (on file with Va. State Bar).

43. *Id.*

44. 715 A.2d 127 (D.C. 1998).

45. *Id.* at 132 n.6.

> of his choice to continue practicing law in competition with the firm. It is only future firm revenues that Neuman will be deprived of, and only because he is at least potentially competing with the firm and effecting a depression of those revenues.[46]

The court buttressed its conclusion regarding the source of the forfeited payments by observing that "[t]here is no language in the partnership agreement to suggest that the [forfeited payout] is funded *in any traceable manner* by the partner receiving the benefit."[47] Along this line, the firm's obligation to make payments was subject to the cash flow limitations set forth in the partnership agreement.[48]

Other courts have indicated or suggested that payouts forfeitable under the retirement benefits exceptions must be sourced in future firm revenues rather than contributions previously made by the retired partner. The Connecticut Supreme Court, for example, has defined retirement payments as benefits "payable from future firm revenues."[49] More recently, the New Jersey Supreme Court emphasized that a forfeiture it was sustaining was a "benefit funded at least in part from revenues" generated subsequent to the departure of the partner.[50] The court also directed the state's Professional Responsibility Rules Committee to consider whether a definition of retirement should be included in the ethics rules.[51]

Because of the law's reticence to impose forfeitures of interests in partnerships, it is understandable that some courts consider the source of the benefit in considering whether a retirement payment may be conditioned on noncompetition with the firm. The challenge lies in tracing the source of a payment. In a law firm, partners "fund" their own postwithdrawal benefits by accepting less in the way of present compensation (i.e., allocation of current profits) in exchange for payments in the future. Any benefit paid to a withdrawing partner is a form of deferred compensation. This is true even of those plans that base benefits to a former firm member on a percentage of the firm's current profits. The profits allocable to the remaining partners are reduced, a consequence the partners accept in the hope they will enjoy similar benefits when they leave the firm.

In *Neuman*, the court recognized the difficulty of tracing the source of a payment and pointed to the partnership agreement's limitation on the obligation to make retirement payments in excess of defined cash flow thresholds as

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46. *Id.* at 136.

47. *Id.* at 136 n.12 (emphasis added).

48. *Id.*

49. Schoonmaker v. Cummings & Lockwood of Conn., P.C., 747 A.2d 1017, 1032 (Conn. 2000).

50. Borteck v. Riker, Danzig, Scherer, Hyland & Perretti, LLP, 844 A.2d 521, 529 (N.J. 2004); *see also* Anderson v. Aspelmeier, Fisch, Power, Warner & Engberg, 461 N.W.2d 598, 603 (Iowa 2000) (striking down a forfeiture relating to the excess of the value of a partner's interest over the partner's capital contribution).

51. *Borteck*, 844 A.2d at 530.

evidence that payments were sourced in post-departure firm revenues.[52] This is not a complete answer to the tracing concern, however, because the firm's revenues are sourced in the efforts of the present set of partners, who accept less in the way of current income in the expectation that they will later receive retirement benefits funded at least in part by the future efforts of partners in the firm.

Given the complexity of tracing the source of a payment to a departed partner and the need to develop a standard with some predictive value, it may be desirable to define and protect from forfeiture a limited but easily determined type of retirement benefit payment that represents a return of quantifiable contributions previously made by the partner. For example, if future payments are funded by defined annual contributions (or withheld distributions), then the amount so contributed bears some similarity to a capital contribution and should not be subject to forfeiture for future competition.

Although earnings on amounts contributed should be entitled to similar protection in theory, the difficulties associated with determining these amounts and properly allocating them to the accounts of partners may be substantial; for this reason it may be prudent to limit the protection against forfeitures to the amounts contributed with no adjustment for earnings on these amounts. The result may seem harsh, but it offers the advantage of simplicity, spares judicial resources, and implements the bargained contract under which retirement payments are to be made.

VII. A POSTSCRIPT ON RETIREMENT: THE LOOK-BACK ISSUE

Assuming payments come within the retirement exception and therefore may be conditioned on noncompetition with the firm, what is to be done if a partner retires, receives some or all of the payments designated as retirement benefits, and then competes with the firm in contravention of the restrictive covenant? To put the question more directly, must the retirement that prompts the payouts be a permanent status, or need retirement only be coterminous with the period over which payments are made? What are the consequences of abandoning retirement?

In *Graubard Mollen Horowitz Pomeranz & Shapiro v. Moskovitz*,[53] a 1990 New York lower court decision, the court correctly concluded that "if the partner abandons his right to these benefits, the restriction ceases to be proper."[54] The

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52. *Neuman*, 715 A.2d at 136 n.12.

53. 565 N.Y.S.2d 672 (Sup. Ct. 1990).

54. *Id.* at 676; *see also* GEOFFREY C. HAZARD & W. WILLIAM HODES, THE LAW OF LAWYERING § 47.4, at 47-5 (3d ed. 2001).

> The purpose and meaning of the exception for "benefits upon retirement" contained in the last clause of Rule 5.6(a) is not crystal clear. It appears to mean that when a lawyer is retiring or winding up his affairs with a firm, he may be required to agree to 'stay retired' as a condition of obtaining payouts from future earnings of the firm. Such a condition is innocuous if limited to the situation given, for in that context it resembles

statement is unremarkable, but it prompts the interesting issue of the recoverability of retirement payments made before the restrictive covenant was breached. As to this question, the court offered noteworthy comments inexplicably excluded from the published opinion:

> This reading will result in some anomalies . . . . If an attorney were to be paid benefits in a lump sum, would he be allowed a year later to change his mind and return to practice although part of the quid pro quo for the lump sum was that he not practice at any time thereafter? If that attorney simply gave up future benefits, he would be giving up nothing. The attorney who wished to return to practice might be made to return the entire lump sum (or at least a proportionate share of it). In the case of permanent periodic benefits, the more likely situation, the attorney may merely forgo future benefits. In the case before me, had Moskovitz left at the end of the five years, he would have received all of the benefits due him, yet, in the Firm's intention, would still be obliged to do nothing to impair the Firm's relationship with its clients . . . . Nevertheless, I conclude that the attorney should be free to change his mind. A firm intent on protecting its client base to the greatest possible extent should tie the constraints the firm seeks directly to the period of the payment.[55]

The court's comment that an attorney who has received all retirement benefits payable "would be giving up nothing" by returning to the practice seems inconsistent with its observation that some or all payments previously made might be recoverable by the firm. In any event, as a practical matter it is far easier to suspend future payments than reclaim past benefits, which is yet another reason for firms to extend the payout period for retirement payments to the maximum extent possible. Changing retirement status may be addressed through the private ordering that underlies partnership agreements.

CONCLUSION

The exclusion of retirement benefits conditioned on noncompetition from the general ban on contractual restraints on competition was of little importance when competition between firms and their former partners was itself a departure from established norms. As lawyer mobility has become a dominant trend within the profession, more firms seek to use the retirement benefits exception as a check on competition.

The difficulty lies in articulating a concept of retirement that is consistent

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pension provisions that reduce benefits for retirees who engage in significant remunerative employment.

Id.

55. *Graubard Mollen Horowitz Pomeranz & Shapiro v. Moskovitz*, N.Y.L.J., May 7, 1990, at 29 (N.Y. Sup. Ct. Apr. 24, 1990).

with the larger changes occurring within the profession, and within society for that matter. This Article has offered a framework that would allow a measure of certainty as to the enforceability of payouts contingent on noncompetition. But this solution is in the nature of a stopgap for an ethics rule in need of reformulation for an era in which competition is encouraged, and mobility, rather than loyalty, is the norm.

THE SUPREME COURT, RULE 10B-5 AND THE FEDERALIZATION OF CORPORATE LAW

MARK J. LOEWENSTEIN*

INTRODUCTION

Beginning in 1975, the U.S. Supreme Court decided a series of cases that effectively limited the reach of Rule 10b-5 of the Securities Exchange Act of 1934,[1] the principal antifraud provision under the federal securities laws.[2] The Court did this either directly, by narrowly interpreting Rule 10b-5 and section

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1. *See* Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994) (holding that there is no basis for aider and abettor liability under Rule 10b-5); Dirks v. SEC, 463 U.S. 646, 665 (1983) (holding that an analyst who passed along material nonpublic information about a public company to his clients did not violate Rule 10b-5 because he did not receive the information from someone who breached his fiduciary duty to the public company); Marine Bank v. Weaver, 455 U.S. 551, 555 (1982) (holding that neither a bank certificate of deposit nor a private profit sharing arrangement was a security); Chiarella v. United States, 445 U.S. 222, 235 (1980) (purchasing securities based on nonpublic information does not violate Rule 10b-5 because the purchaser had no common law duty of disclosure to the sellers); Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 570 (1979) (finding that a noncontributory, compulsory pension plan is not an investment contract and therefore not a security); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 475-76 (1977) (ruling that breach of fiduciary duty cannot be the basis for a claim under Rule 10b-5; the plaintiff must allege and prove that the defendant engaged in manipulative or deceptive conduct to state a claim under the Rule); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 214 (1976) (holding that negligence cannot be the basis for an action under Rule 10b-5 and that the plaintiff must allege and prove scienter); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 754-55 (1975) (finding that only purchasers and sellers of securities have standing to maintain a private cause of action for damages under Rule 10b-5 and that mere offerees do not); *see also* Gustafson v. Alloyd Co., 513 U.S. 561, 584 (1995) (holding that the remedy under section 12(a)(2) of the Securities Act of 1933 is limited to purchasers of securities in a public offering by an issuer or a controlling shareholder of the issuer).

2. 17 C.F.R. § 240.10b-5 (1998). The Rule provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

10(b),[3] on which the Rule is based, or by interpreting the definition of "security" narrowly.[4] In either case, the Court's apparent intent was to limit the reach of the Rule. In *Blue Chip Stamps v. Manor Drug Stores*,[5] the Court held that a private cause of action under the Rule was available only to purchasers and sellers of securities.[6] Offerees who alleged that they were dissuaded from purchasing stock by an intentionally misleading prospectus thus lacked standing to maintain an action. Although there was support for the plaintiffs' position, the Court opted for a narrow reading by citing the threat of "vexatious litigation."[7]

The Court's skepticism of litigation under Rule 10b-5 was evident in several other prominent decisions,[8] culminating in its 1994 decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*[9] There, the Court denied a cause of action under the Rule against alleged aiders and abettors of a primary violator of the Rule.[10] This decision was particularly striking because the issue had not been raised by the defendant/petitioner in its initial appeal of an unfavorable ruling below on other issues; rather, the Court directed the parties to brief this issue in its grant of certiorari.[11] The Court's decision was also striking because the lower federal courts had consistently recognized an implied right of action under Rule 10b-5 against aiders and abettors.[12] The Court in *Central Bank* seemed to be intent on continuing to rein in Rule 10b-5 private actions. One theme common to several of these cases, and especially prominent in the 1977 decision of *Santa Fe Industries, Inc. v. Green*,[13] was a recognition of the possible role of state law in providing a remedy for the plaintiff. Even in the absence of an express recognition of a role for the states, these decisions had the effect of curbing national power, recognizing a limit to the growth of the "oak"

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3. 15 U.S.C. § 78j(b) (2000).

4. *See* cases cited *supra* note 1.

5. 421 U.S. 723 (1975).

6. *Id.* at 754-55.

7. *Id.* at 724. The Court reversed a contrary holding of the Ninth Circuit Court of Appeals, *Manor Drug Stores v. Blue Chip Stamps*, 492 F.2d 136 (9th Cir. 1973), *rev'd*, 421 U.S. 723 (1975), and drew a stinging dissent from three Justices. *Blue Chip Stamps*, 421 U.S. at 762 (Blackmun, J., dissenting) ("[T]he Court exhibits a preternatural solicitousness for corporate well-being and a seeming callousness toward the investing public quite out of keeping, it seems to me, with our own traditions and the intent of the securities laws.").

8. *See* cases cited *supra* note 1.

9. 511 U.S. 164 (1994).

10. *Id.* at 191.

11. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 508 U.S. 959 (1993).

12. *Cent. Bank*, 511 U.S. at 192 (Stevens, J., dissenting) ("In *hundreds* of judicial and administrative proceedings in every Circuit in the federal system, the courts and the SEC have concluded that aiders and abettors are subject to liability under § 10(b) and Rule 10b-5.") (referring to 5B A. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10B-5 § 40.02 (rev. ed. 1993)).

13. 430 U.S. 462, 478 (1977).

tree that litigation under the Rule had become.[14]

The tendency to be stingy in anti-fraud cases was also evident in another strain of Rule 10b-5 cases—the insider trader cases. In *Chiarella v. United States*[15] and *Dirks v. SEC*,[16] the state law of fiduciary duty played a prominent role in the Court's decision to reject claims that the defendants in those cases engaged in insider trading in violation of Rule 10b-5. Not everyone in possession of material, nonpublic information was prohibited from trading on or selectively disclosing that information.[17] Only those who breached a fiduciary duty by trading on the information, or those who received the information from someone who breached a fiduciary duty, could violate the Rule.

Although this twenty-year history of jurisprudence was not without exceptions,[18] the thrust of the Court's jurisprudence seemed undeniable. As the 1990s drew to a close, however, the Court seemed to adopt a different tack. In the four most recent cases that it has decided under Rule 10b-5 and the federal securities laws, the Court has expanded the reach of both. Even though each of the decisions is defensible on its own terms, the cases taken together appear to reject the philosophy of the Court's earlier decisions. In the sole case involving a private action for damages, *Wharf (Holdings) Ltd. v. United International Holdings, Inc.*,[19] the plaintiff had a well-established, common law remedy against the defendant, yet the Court upheld the claim under the Rule.[20] In two SEC enforcement actions, *SEC v. Edwards*[21] and *SEC v. Zandford*,[22] the Court upheld the Commission's use of the Rule by giving a liberal reading to two different sections of the Exchange Act. Similarly, in *United States v. O'Hagan*,[23] the Court upheld a criminal conviction under a broad reading of the Rule.[24] With the exception of the *O'Hagan* case, which has drawn a significant amount of

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14. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975) ("When we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn.").

15. 445 U.S. 222, 235 (1980).

16. 463 U.S. 646, 655 (1983).

17. *See* SEC v. Texas Gulf Sulfur Co., 401 F.2d 833, 843 (2d Cir. 1968) (holding that anyone who trades on the basis of material, nonpublic information violates Rule 10b-5). *But see Chiarella*, 445 U.S. at 225 (purchasing securities based on nonpublic information does not violate Rule 10b-5 because the purchaser had no common law duty of disclosure to the sellers).

18. *See, e.g.*, Reves v. Ernst & Young, 494 U.S. 56, 73 (1990) (holding that demand notes issued by farmer's cooperative are securities); Herman & MacLean v. Huddleston, 459 U.S. 375, 386-87 (1983) (finding a remedy available under Rule 10b-5 despite availability of a remedy under section 11 of the Securities Act of 1933).

19. 532 U.S. 588 (2001).

20. *Id.* at 595-97.

21. 540 U.S. 389, 397 (2004).

22. 535 U.S. 813, 825 (2002).

23. 521 U.S. 642 (1997).

24. *Id.* at 667.

scholarly comment,[25] these decisions have gone largely unnoticed.

Scholars and other court observers who have postulated about the "new federalism" in the Supreme Court—the notion that the Court has a new-found respect for the role of state law in our federal system—would be well advised to consider these securities laws cases. These cases signal a different judicial philosophy. This philosophy is not only at odds with a few high-profile decisions under the Commerce Clause[26] and the Tenth Amendment,[27] but it is also at odds with earlier decisions of the Court in the area of securities law. Indeed, a cynic might consider the new federalism cases to be an anomaly, with the reality being that the Court is still as nationalistic in its approach as it traditionally has been. If the securities laws cases discussed in this Article are any indication, the Court is becoming even more nationalistic.[28]

This Article examines Supreme Court jurisprudence since 1997 under the federal securities laws, particularly Rule 10b-5, in light of the Court's earlier decisions and its recent decisions construing the Constitution and federal statutes as they relate to the regulation of business. Part I considers the Court's earlier decisions under the federal securities laws, which stand in contrast to the more recent decisions (*O'Hagan*, *Wharf*, *Zandford*, and *Edwards*) discussed in Part II. Part III then considers developments beyond the Supreme Court's Rule 10b-5 jurisprudence and places those developments in the context of the Court's tendency to prefer national solutions to a wide variety of problems, thereby directly or indirectly preempting state law. The cases in Part III present the question of federal-state relations or the role of federalism on our legal landscape. Although in general this topic does not beg for further scholarly

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25. *See, e.g.*, Stephen M. Bainbridge, *Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud*, 52 SMU L. REV. 1589 (1999); Richard W. Painter et al., *Don't Ask, Just Tell: Insider Trading After* United States v. O'Hagan, 84 VA. L. REV. 153 (1998); A.C. Pritchard, United States v. O'Hagan*: Agency Law and Justice Powell's Legacy for the Law of Insider Trading*, 78 B.U. L. REV. 13 (1998). *But see* Randall W. Quinn, *The Misappropriation Theory of Insider Trading in the Supreme Court: A (Brief) Response to the (Many) Critics of* United States v. O'Hagan, 8 FORDHAM J. CORP. & FIN. L. 865 (2003) (supporting the Court's holding but noting the scholarship critical of the Court).

26. *See* United States v. Morrison, 529 U.S. 598, 617 (2000) (holding unconstitutional the Federal Violence Against Women Act); United States v. Lopez, 514 U.S. 549, 551 (1995) (holding unconstitutional the Gun-Free School Zones Act of 1990); *see also infra* notes 146-69.

27. *See* Printz v. United States, 521 U.S. 898, 935 (1997) (holding that Congress lacked the authority to "commandeer" state officials into implementing a federal regulatory program); New York v. United States, 505 U.S. 144, 149 (1992) (same). *But see* Reno v. Condon, 528 U.S. 141, 149 (2000) (holding that no commandeering occurs if Congress restricts the ability of state officials to share a driver's personal information without consent).

28. *See, e.g.*, ROBERT F. NAGEL, THE IMPLOSION OF AMERICAN FEDERALISM (Oxford University Press 2001). Viewing the new federalism cases in a broader context, Professor Nagel concluded that: "[T]he record as a whole is mixed enough to cast doubt on the idea that devotion to decentralized decision making is now an overriding value for most members of the Court." *Id.* at 28.

commentary,[29] little note has been taken of the Court's work in the commercial area or how the Court's decisions interpreting federal law have limited the traditional role of the states.

I. THE COURT'S EARLIER DECISIONS

The Court's 1975 decision in *Blue Chip Stamps* was an indication that the Court believed that Rule 10b-5 had to be cabined. That decision was a reaction not only to the increase in securities litigation in the federal courts (which have exclusive jurisdiction over securities fraud cases under Rule 10b-5),[30] but also to decisions of the Warren Court recognizing "implied rights of action" under federal statutes. A prime example of this was the 1964 decision in *J.I. Case Co. v. Borak*,[31] in which the Court recognized an implied right of action under section 14(a) of the Exchange Act, which regulates the solicitation of proxies in publicly held companies.[32] In *Borak*, the Court reasoned that a private right of action, even though not provided for by Congress, would promote investor protection and would serve as an important supplement to SEC enforcement actions;[33] private plaintiffs would then serve as "private attorneys general."[34] The Warren Court thus adopted an instrumental test for recognizing implied rights.[35]

The Burger Court rejected this judicial philosophy and announced, in *Cort v. Ash*,[36] a new standard for recognizing an implied right of action.[37] Henceforth, the plaintiff seeking recognition of an implied right would have to satisfy a four-part test:

> In determining whether a private remedy is implicit in a statute not expressly providing one, several factors are relevant. First, is the

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29. Dozens of articles on federalism are published annually. *See, e.g.*, Erwin Chemerinsky, *The Federalism Revolution*, 31 N.M. L. REV. 7 (2001); Erwin Chemerinsky, *Formalism and Functionalism in Federalism Analysis*, 13 GA. ST. U. L. REV. 959 (1997); Allison H. Eid, *Federalism and Formalism*, 11 WM. & MARY BILL RTS. J. 1191 (2003); Richard H. Fallon, Jr., *The "Conservative" Paths of the Rehnquist Court's Federalism Decisions*, 69 U. CHI. L. REV. 429 (2002); Vicki C. Jackson, *Federalism and the Uses and Limits of Law:* Printz *and Principle?*, 111 HARV. L. REV. 2180 (1998); Larry Kramer, *Understanding Federalism*, 47 VAND. L. REV. 1485 (1994); Philip J. Weiser, *Towards a Constitutional Architecture for Cooperative Federalism*, 79 N.C. L. REV. 663 (2001).

30. Securities Exchange Act of 1934, 15 U.S.C. § 78a (2000).

31. 377 U.S. 426 (1964).

32. *Id.* at 432-34.

33. *Id.* at 432.

34. Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 61 n.13 (1977) (noting the importance of this concept in enforcing federal law); *see Borak*, 377 U.S. at 432.

35. The Court stated: "While [§ 14(a)] makes no specific reference to a private right of action, among its chief purposes is 'the protection of investors,' which certainly implies the availability of judicial relief where necessary to achieve that result." *Borak*, 377 U.S. at 432.

36. 422 U.S. 66 (1975).

37. *Id.* at 78.

> plaintiff "one of the class for whose especial benefit the statute was enacted,"—that is, does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one? Third, is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff? And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law?[38]

At issue in *Cort* was whether the plaintiff could maintain a derivative suit alleging an implied right of action under a federal criminal statute that prohibited corporations from making campaign contributions in Presidential elections.[39] The plaintiff, a shareholder of Bethlehem Steel Corp., claimed that the president of the corporation violated the federal statute and sought injunctive relief and monetary damages. Applying its four-factor test, the Court concluded that the plaintiff could not maintain a derivative action based on the statute.[40]

With regard to the fourth part of the test, which focuses on the role of state law, the Court expressed several concerns. First, if the defendant's conduct violates his fiduciary duties under state law, the claim should rest on that.[41] Second, just the opposite may be the case—state law may permit corporations to contribute to state elections, in which case shareholders would be on notice that corporate funds could be so employed and that there could be no federal recovery.[42] Finally, and most importantly, the presence or lack of a state remedy would have no effect on the realization of Congress's purpose in enacting the statute in question.[43] Congress was not concerned with regulating the internal affairs of corporations, as it was when it regulated the solicitation of proxies, but rather it sought to "dull[] [corporations'] impact upon federal elections."[44] To achieve this, it was not critical to recognize a private right of action for violation of the statute, or, in the Court's words: "the existence or nonexistence of a derivative cause of action for damages would not aid or hinder this primary goal."[45]

One can quibble with the Court's analysis. Surely the potential of a private damage remedy would add a deterrent effect to corporate officers who otherwise would be inclined to violate the statute. Logically, a private action would further Congress's goal of dulling the corporate impact on federal elections. Even if state law permitted corporate contributions to state elections, shareholders would not be on notice that corporate funds could be expended for federal elections.

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38. *Id.* (citations omitted).
39. 18 U.S.C. § 610 (2000); *Cort*, 422 U.S. at 68.
40. *Cort*, 422 U.S. at 85.
41. *Id.* at 84.
42. *Id.*
43. *Id.*
44. *Id.*
45. *Id.*

Indeed, considering the federal criminal statute, shareholders could expect just the opposite. In light of these factors, it appears that the Court was simply reluctant to recognize an implied right of action and was backpedaling on *Borak*.

More importantly, in *Cort*, the Court was demonstrating a high sensitivity to state law. Although an intentional violation of a criminal statute would constitute a breach of fiduciary duty under state law,[46] the plaintiff preferred to base its claim on a federal statute to avoid having to post security for expenses. Perhaps the Court merely wanted to avoid interfering with the state policy of regulating derivative actions. If that is true, the Court was subordinating the importance of federal election laws to this state policy,[47] and demonstrating a sensitivity to state law that contrasts sharply with its recent decisions.

In retrospect, *Cort* was only a weigh station on the route to the virtual demise of implied private actions under federal statutes. In 1979, the Court refused to find an implied right of action under the antifraud provision of the Investment Advisors Act section 206[48] or section 17(a) of the Exchange Act, which is also an antifraud provision.[49] In the case decided under the Investment Advisors Act, the Court explained its evolved view on private rights of action:

> The question whether a statute creates a cause of action, either expressly or by implication, is basically a matter of statutory construction. While some opinions of the Court have placed considerable emphasis upon the desirability of implying private rights of action in order to provide remedies thought to effectuate the purposes of a given statute, [citing] *J. I. Case Co. v. Borak*, what must ultimately be determined is whether Congress intended to create the private remedy asserted, as our recent decisions have made clear. We accept this as the appropriate inquiry to be made in resolving the issues presented by the case before us.[50]

The implied right of action cases are a nice compliment to the restricted view the Court took in Rule 10b-5 cases starting with *Blue Chip Stamps*. The Court seemed to say in *Blue Chip Stamps* that although it could not recede from recognizing a private action under Rule 10b-5, because a private right had been long recognized by the federal courts, the right would have to be limited.[51] *Blue*

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46. *See, e.g.*, Twenty First Century L.P.I v. LaBianca, 19 F. Supp. 2d 35, 40-44 (E.D.N.Y. 1998).

47. *See* Alison Grey Anderson, *The Meaning of Federalism: Interpreting the Securities Exchange Act of 1934*, 70 VA. L. REV. 813, 826 (1984).

48. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 18 (1979); *see* 15 U.S.C. §§ 80b-1 to 80b-15 (2000).

49. Touche Ross & Co. v. Redington, 442 U.S. 560, 573-74 (1979); *see* 15 U.S.C. § 78g (2000).

50. *Transamerica*, 444 U.S. at 15-16 (citations omitted).

51. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 730 (1975) ("This Court had no occasion to deal with the subject until 25 years [after a district court recognized a private right of action in *Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1945)], and at that time we confirmed with virtually no discussion the overwhelming consensus of the District Courts and

Chip Stamps fits nicely into this rubric. The Court based its decision on policy considerations, primarily holding that recognizing a claim under these circumstances would enhance the possibility of groundless and vexatious litigation.[52]

Two years after *Blue Chip Stamps*, the Court decided *Santa Fe Industries, Inc. v. Green*, a case laden with potential significance.[53] In *Santa Fe*, the plaintiffs, minority shareholders of Kirby Lumber Corp., sought to use Rule 10b-5 to challenge a freeze-out merger engineered by Kirby's ninety-five percent stockholder, Santa Fe. The plaintiffs complained that Santa Fe breached its fiduciary duty to the minority shareholders by failing to pay a fair price for their shares. Reversing the appellate court, the Supreme Court again limited the reach of Rule 10b-5 by holding that only manipulations and deceptions are within the Rule's proscriptions.[54] According to the Court, breaches of fiduciary duty not involving a manipulation or deception are matters of state law, not federal law.[55]

Santa Fe provided the Court with the opportunity to apply its recent decision in *Cort v. Ash*. Focusing particularly on the effect on state law of recognizing a private right of action under the Rule for breach of fiduciary duty, the Court noted that such an "extension of the federal securities laws would overlap and quite possibly interfere with state corporate law."[56] The Court explained that federal courts would have to craft a uniform rule of fiduciary duty that might diverge from the law in some states.[57] In theory, conduct could violate this federal fiduciary duty rule and not violate state fiduciary standards. However, it is unclear why, from a policy perspective, this would be problematic. If certain conduct constituted a breach of fiduciary duty under the federal rule but not the state rule, the complaining shareholder would have a federal but not a state claim, and vice versa, if the conduct violated state standards but not federal standards. In the area of disclosure, a similar divergence exists; a misrepresentation may be material for purposes of state law, but not federal.[58] The important point is not

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Courts of Appeals that such a cause of action did exist.").

52. *Id.* at 740.

53. Sante Fe Indus., Inc. v. Green, 430 U.S. 462 (1977).

54. *Id.* at 474.

55. *Id.* at 478-80.

56. *Id.* at 479.

57. *Id.*

58. For instance, the Delaware Supreme Court has announced a bright-line rule that merger negotiations are not material until the parties have agreed on the price and structure of the transaction. Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 847 n.5 (Del. 1987). The federal rule is that merger negotiations may be material at an earlier stage. Basic Inc. v. Levinson, 485 U.S. 224, 249 (1988). *But see* Alessi v. Beracha, 849 A.2d 939, 946-50 (Del. Ch. 2004) (questioning the rule in *Bershad* and holding that merger negotiations may become material at an earlier point). If the Delaware Supreme Court affirms the lower court's decision in *Alessi*, state and federal law would be consistent; however, several Delaware decisions since the *Bershad* decision have followed it. *See, e.g.*, *In re* MONY Group Inc. S'holder Litig., 852 A.2d 9, 29 (Del. Ch. 2004); Krim v. Pronet, Inc., 744 A.2d 523, 528-29 (Del. Ch. 1999); Shamrock Holdings, Inc. v. Polaroid Corp.,

whether the standards are different, but instead what is the effect of different standards. In the area of fiduciary duties, different standards may mean that fiduciaries have to be cognizant of, and conform to, the higher standard, be it federal or state. This may be a good thing, at least from the perspective of investors. Regardless of whether there would be real interference, the significance of *Santa Fe* is that the Court respected the traditional sphere of state law.

This approach was prominent in another 1977 decision, *Piper v. Chris-Craft Industries, Inc.*,[59] a case deciding whether an unsuccessful tender offeror had standing under section 14(e) of the Exchange Act to bring an action alleging fraud by the successful competitor and others. Section 14(e) of the Williams Act, which is a federal statute adopted in 1968 to regulate tender offers, is similar in structure and content to Rule 10b-5;[60] on that basis alone, there was a rationale for finding a private right of action.[61] Based on its review of the legislative history of the Williams Act, and an application of the four-factor *Cort* test, the Court concluded that the plaintiff did not have standing.[62] With reference to the relevance of state law, the Court approved the appellate court's conclusion that, under common law principles, the plaintiff would have a cause of action for interference with prospective economic advantage.[63] The presence of this state law remedy helped persuade the Court not to recognize a federal remedy under the Williams Act.[64]

State law continued to be a consideration for the Court in several prominent cases related to the federal securities laws. In *Burks v. Lasker*,[65] the Court

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559 A.2d 257, 275 (Del. Ch. 1989).

59. 430 U.S. 1, 54 (1977).

60. Securities Exchange Act of 1934, § 14(e), as amended 15 U.S.C. § 78n(e), provides:

> (e) Untrue statement of material fact or omission of fact with respect to tender offer
> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

15 U.S.C. § 78n(e) (2000). *See generally* Mark J. Loewenstein, *Section 14(e) of the Williams Act and the Rule 10b-5 Comparisons*, 71 GEO. L.J. 1311 (1983) (explaining why 14(e) might be more broadly construed than Rule 10b-5).

61. *Piper*, 430 U.S. at 41.

62. *Id.* at 42 n.28.

63. *Id.* at 16.

64. *Id.* at 41, 42.

65. 441 U.S. 471, 486 (1979) (alleging violations of the Investment Company Act and the Investment Advisors Act).

decided that the trial court should look to state law to determine whether a committee appointed by the board of directors of a federally regulated investment company had the authority to terminate a shareholder's derivative action alleging violations of the federal securities laws by the directors. Also, in *CTS Corp. v. Dynamics Corp.*,[66] the Court upheld a state law limiting the ability of a tender offeror to consummate an offer over objections that the state statute was (1) inconsistent with the Williams Act and thus preempted by it, and (2) ran afoul of the Commerce Clause, because it interfered with interstate offers for securities.[67] In the course of its opinion, the Court noted the role of state law:

> It thus is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares. A State has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.[68]

By 1994, however, this sensitivity to the relationship between state and federal law was remarkably absent from an opinion that sharply limited Rule 10b-5.[69] In its controversial *Central Bank* decision, the Court held that neither the language of section 10(b) nor the general structure of the federal securities laws supported the recognition of a claim under Rule 10b-5 for civil liability against alleged aiders and abettors of primary violators.[70] *Central Bank* was

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66. 481 U.S. 69 (1987).

67. *Id.* at 94.

68. *Id.* at 91.

69. The shift in the Court's securities laws jurisprudence may simply be explained by the retirement of Justice Powell after the 1986-87 term. Justice Powell had an interest and expertise in business law that he brought to bear as a member of the Court. He had a profound influence on the Court during his tenure, authoring several key decisions. With his departure, the Court took fewer securities laws cases and seemed to do an inferior job in deciding them. Professor Pritchard's excellent article details this history. A. C. Pritchard, *Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841 (2003). He concludes:

> Since Powell's retirement, the Court's forays into [the federal securities laws] have been occasionally impenetrable and sometimes bizarre. On other occasions the Court simply regurgitates the party line offered by the SEC. Overall, "scholars and learned practitioners are giving the Court's securities law opinions low grades for logic, clarity, and usefulness in future cases."

Id. at 949 (quoting Donald C. Langevoort, *Words from on High About Rule 10b-5:* Chiarella*'s History,* Central Bank*'s Future*, 20 DEL. J. CORP. L. 865, 868 (1995) (citations omitted)). In this Article, I seek to sort out this chaos with an explanation that harmonizes the Court's securities laws opinions with its broader tendency to prefer national solutions to problems. Justice Powell resisted this tendency, making securities laws decisions during his tenure somewhat distinctive from the rest of the Court's jurisprudence.

70. Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191-92 (1994).

decided against a long history of recognition of aider and abettor liability; all eleven U.S. Courts of Appeals that considered the issue upheld a private cause of action against aiders and abettors.[71] Indeed, as Justice Stevens noted in his dissent, the petitioner in this case "*assumed* the existence of a right of action against aiders and abettors, and sought review only of the subsidiary questions."[72] The Court, sua sponte, asked the parties to address the issue.[73] *Central Bank* thus represents a Court actively seeking to limit the contours of the Rule without concern for the interrelationship of federal and state law.

In fact, the securities laws of some states include provisions allowing for aider and abettor liability.[74] The denial of a federal claim raises the importance of state law in this area in the same way that denial of a claim under *Santa Fe* did, yet the *Central Bank* Court did not cite that as a justification for its holding.[75] This oversight raises doubt whether the concern about state law expressed in *Santa Fe* was genuine. Indeed, as noted above, the Court's expressed concern in *Santa Fe* is difficult to assess on its own terms. Perhaps, recognizing the vacuity of such a concern, the Court abandoned all reference to it in *Central Bank*. In any case, the absence of an expressed state law concern, even in the context of a limitation on Rule 10b-5, is consistent with the approach taken in the modern cases, as explained in the next section.[76]

II. A NEW APPROACH?: THE *O'HAGAN*, *WHARF*, *ZANDFORD*, AND *EDWARDS* CASES

A. O'Hagan

O'Hagan, the first decision in a quartet of cases, answered a significant

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71. *Id.* at 192-93 (Stevens, J., dissenting).

72. *Id.* at 194.

73. *Id.* at 194-95.

74. *See, e.g.*, Conn. Nat'l Bank v. Giacomi, 699 A.2d 101, 117 (Conn. 1997) (recognizing aider and abettor liability under Connecticut law).

75. *Central Bank*, 511 U.S. at 191-92.

76. The notion that federalism is merely a mask for policy preference and not a real concern in securities law cases was the focus of an article written some twenty years ago by Professor Anderson. Anderson, *supra* note 47, at 856. She concluded that the Court's federalism concerns were less than sincere:

> In the corporate and securities area, the rhetoric of federalism should not be allowed to confuse and obscure discussion of the major substantive policy choices that usually lie behind the invocation of state interests, including questions concerning the appropriate balance of managerial autonomy and shareholder protection, the proper role of individual litigation in corporate governance, the benefits and evils of insider trading, and the social value of contested takeovers. Although these issues all involve difficult empirical questions and controversial value choices that are unlikely to be readily resolved, eliminating the vocabulary of federalism from the discussion will at least clear the air.

Id.

question in the world of insider trading—whether one who is not himself an insider but who misappropriates inside information and trades on that information violates Rule 10b-5?[77] James O'Hagan was a partner in Dorsey & Whitney, a law firm that represented Grand Metropolitan PLC, a U.K. company that planned to make a hostile tender offer for the Pillsbury Company. Knowing of the plans of his firm's client, and expecting a quick, risk-free profit, O'Hagan purchased shares and call options of Pillsbury over the stock exchange and sold those securities at a large profit when Grand Metropolitan's offer was made public.[78] He thus "misappropriated," for his own use, the confidential plans of his client. The government charged that this misappropriation was a violation of section 10(b) and Rule 10b-5. Because section 10(b) limits federal jurisdiction to manipulative or deceptive devices or contrivances used in connection with the purchase or sale of a security, the government had to demonstrate how O'Hagan's misappropriation satisfied the jurisdictional requirement.[79] O'Hagan, the misappropriator of inside information, may have "deceived" his client[80] and purchased securities; however, are the two sufficiently linked? That is, in the parlance of section 10(b), was the deception "in connection with" the purchase or sale of a security?[81] In *O'Hagan*, the Court concluded that they were sufficiently linked, pushing the "in connection with" requirement to its outer limit, or perhaps beyond.[82]

To reach its conclusion, the Court sought support in the language of section 10(b): "[The section], as written, does not confine its coverage to deception of a purchaser or seller of securities; rather, the statute reaches any deceptive device used 'in connection with the purchase or sale of any security.'"[83] This is true enough, but it begs the question of whether there is a sufficient nexus between the deception and the securities transaction. If a person's deception causes another to entrust her with a valuable piece of art which she then sells, using the proceeds to purchase corporate stock, there is a deception and a securities transaction, but is there a violation of section 10(b)? No court or commentator

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77. United States v. O'Hagan, 521 U.S. 642 (1997). This issue first came before the Supreme Court in *Chiarella v. United States*, 445 U.S. 222 (1980), as an alternative basis for upholding the defendant's conviction on charges of insider trading. A majority of the Court, however, decided that the issue had not been raised below and therefore was not properly before the Court. *Chiarella*, 445 U.S. at 236-37.

78. *O'Hagan*, 521 U.S. at 647-48.

79. *Id.* at 650-51.

80. The deception arises because the misappropriator does not disclose to the source that he or she intends to trade on the information. Thus, if the misappropriator discloses his intentions, there is no deception and no violation of section 10(b) (or Rule 10b-5). However, this use of the term "deception" is a bit unusual because the source of the information was not "deceived" into taking any action, a typical element in the tort of deception. The problem is more acute if the misapropriator forms his intention after acquiring the information.

81. *O'Hagan*, 521 U.S. at 653.

82. *Id.* at 656.

83. *Id.* at 651 (citation omitted).

has ever suggested that a violation exists in such a situation.[84]

Perhaps mindful of this slippery slope, the Court grounded its decision on a policy basis, opining that the misappropriation theory is "well tuned to an animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence."[85] This policy-based argument drew a vigorous dissent from Justice Thomas (joined by Chief Justice Rehnquist), who wrote:

> [R]epeated reliance on such broad-sweeping legislative purposes reaches too far and is misleading in the context of the misappropriation theory. It reaches too far in that, regardless of the overarching purpose of the securities laws, it is not illegal to run afoul of the "purpose" of a statute, only its letter. The majority's approach is misleading in this case because it glosses over the fact that the supposed threat to fair and honest markets, investor confidence, and market integrity comes not from the supposed fraud in this case, but from the mere fact that the information used by O'Hagan was nonpublic.[86]

Justice Thomas might have added that the majority opinion lacked any empirical basis for its assertions on investor confidence and market integrity. Even under the majority's view, O'Hagan could have traded if he made disclosure to his client; such disclosure would have eliminated the "deception." However, trading of this nature would still leave other traders in the market at an informational disadvantage, as they often are. Apparently, neither this sort of informational

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84. The Court cited with approval the Commission's use of a similar illustration to establish the boundaries of the misappropriation theory:

> In such a case, the Government states, "the proceeds would have value to the malefactor apart from their use in a securities transaction, and the fraud would be complete as soon as the money was obtained." In other words, money can buy, if not anything, then at least many things; its misappropriation may thus be viewed as sufficiently detached from a subsequent securities transaction that § 10(b)'s "in connection with" requirement would not be met.

Id. at 656-57 (citations omitted). The problem is the phrase's vagueness. As Professor Ribstein has pointed out: "With respect to insider trading, ['in connection with'] can range from requiring privity between the plaintiff and defendant, as the Eighth Circuit held in *O'Hagan*, to requiring only some effect on securities markets, as the Supreme Court held." Larry E. Ribstein, *Federalism and Insider Trading*, 6 SUP. CT. ECON. REV. 123, 142 (1998).

85. *O'Hagan*, 521 U.S. at 658. The Court further explained:

> Although informational disparity is inevitable in the securities markets, investors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law. An investor's informational disadvantage vis-à-vis a misappropriator with material, nonpublic information stems from contrivance, not luck; it is a disadvantage that cannot be overcome with research or skill.

Id. at 658-59.

86. *Id.* at 689 (Thomas, J., dissenting).

disadvantage, nor other kinds of informational disadvantages, has destroyed investor confidence. In any case, if the purpose of the federal securities laws is to protect investors, it is unclear how a ban on insider trading achieves that.[87] In addition, if the purpose of the law is to enhance pricing accuracy, a ban on insider trading works in the opposite direction because insider trading either has no effect on prices or, more likely, has a signaling effect that moves the market in the right direction.[88] Finally, and most importantly, the Court departed from what Congress apparently sought to achieve with section 10(b).[89] There is no support for the idea that Congress sought to address insider trading in section 10(b), having expressly dealt with that issue in § 16(b) of the Exchange Act.[90]

Although there are various arguments to ban or limit insider trading,[91] the issue in *O'Hagan* was whether the Court should stray from an analysis based on text and legislative history to implement what it perceived as sound public policy. In an apparent departure from its earlier precedents, as discussed above, the Court demonstrated a willingness to move beyond the text of section 10(b). What is missing from the Court's decision is any consideration of whether O'Hagan's conduct is better addressed by state law. At most, O'Hagan's offense was using information of his firm's client for his personal enrichment, thereby committing a gross breach of fiduciary duty. Such conduct may well violate state

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87. *See* HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 93-110 (1966) (challenging the then prevailing notion that insider trading should be banned as harmful to investors); Jonathan R. Macey, *Securities Trading: A Contractual Perspective*, 50 CASE W. RES. L. REV. 269, 273 ("[A]s long as the insider trading did not cause the trading by the outsider—that is, as long as the outsider would have traded anyway—then insider trading may be seen as beneficial, at least to the shareholders who are selling while the insiders are buying and those buying while the insiders are selling."). *But see* WILLIAM K.S. WANG & MARC I. STEINBERG, INSIDER TRADING 41-117 (1996) (identifying potential harms to individual investors from insider trading).

88. *See* Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 DUKE L.J. 977 (1992) (analyzing the benefits from repealing insider trading limitations); Ribstein, *supra* note 84, at 127-28 (reviewing the arguments against restrictions on insider trading).

89. *See* Smolowe v. Delendo Corp., 136 F.2d 231, 235-36 (2d Cir. 1943) (suggesting that Congress addressed insider trading through section 16(b), a strict liability prophylactic rule). When the SEC adopted Rule 10b-5, it did not indicate that it was intended to address insider trading. *See* 7 Fed. Reg. 3804 (1942); *see also Conference on Codification of Federal Securities Laws*, 22 BUS. LAW. 793, 921-23 (1967) (explaining that the rule was originally drafted to address market manipulation). *But see* Quinn, *supra* note 25, at 865 (arguing that *O'Hagan* was correctly decided). *See generally* Michael P. Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1, 55-69 (1980); Painter et al., *supra* note 25, at 160 n.29 (describing scholarship on the purpose of section 10(b)); Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 425-61 (1990).

90. 15 U.S.C. § 78p(b) (2000).

91. *See generally* WANG & STEINBERG, *supra* note 87, at 29-39 (discussing whether insider trading harms securities markets, the issuer, or the trader's employer).

criminal law,[92] but, in any event, it is a stretch to conclude that this is the sort of conduct that Congress had in mind when it adopted section 10(b). The Court is correct that Congress sought to protect investors through the federal securities laws, but the *O'Hagan* decision addresses breach of fiduciary duty, the sort of conduct that *Santa Fe* held was *not* covered by section 10(b).[93] As noted above, in *Santa Fe*, the directors breached their fiduciary duty to the shareholders, enabling them to purchase shares at an unfair price.[94] So framed, *O'Hagan* is difficult to distinguish.

B. Zandford

Like *O'Hagan*, *Zandford* raised the "in connection with" test in the context of an SEC enforcement action against a stockbroker who stole money from his clients: an elderly man in poor health and his mentally retarded daughter.[95] Zandford, who had discretion to manage his clients' account, sold securities in the account and transferred the proceeds to himself. After his criminal conviction for mail fraud, the SEC brought this enforcement action, claiming a violation of section 10(b) and Rule 10b-5. The district court entered summary judgment against Zandford, but the Court of Appeals for the Fourth Circuit reversed, holding that there was not a sufficient connection between Zandford's theft and a securities transaction: "Here, Zandford's securities sales were incidental to his scheme to defraud. Zandford's fraud lay in absconding with the proceeds of the sales. The record contains no suggestion that the sales themselves were conducted in anything other than a routine and customary fashion."[96] The Supreme Court reversed the appellate court, relying, in part, on its decision in *O'Hagan*.[97]

Key to the Court's decision was the principle that there need not "be a misrepresentation about the value of a particular security in order to run afoul of the [Securities Exchange] Act."[98] Additionally, although one of the purposes of the Act was to preserve "the integrity of the securities markets,"[99] section 10(b) covers deceptions involving securities transactions that are conducted face to face as well as in organized markets.[100] Thus, the only question was whether the admitted "fraud coincided with the sales" of the securities.[101] That occurred here because the respondent's scheme, formed shortly after the account was opened, was to misappropriate the proceeds of securities sales. The Court observed that

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92. *E.g.*, People v. Napolitano, 724 N.Y.S.2d 702, 708 (App. Div. 2001).

93. Sante Fe Indus. v. Green, 430 U.S. 462, 474-76 (1977).

94. *Id.* at 466-67.

95. SEC v. Zandford, 535 U.S. 813, 815 (2002).

96. SEC v. Zandford, 238 F.3d 559, 564 (4th Cir. 2001), *rev'd*, 535 U.S. 813 (2002).

97. *Zandford*, 535 U.S. at 825.

98. *Id.* at 820.

99. *Id.* at 821 (quoting Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 9 (1971)).

100. *Id.* at 822.

101. *Id.* at 820.

the actual misappropriation was not a necessary element of the claim.[102]

The Court's decision is eminently defensible and supported by its own precedents.[103] Yet, like *O'Hagan*, one wishes for more. The case recognizes an implied cause of action for what is essentially a breach of fiduciary duty and, unlike *O'Hagan*, that breach of fiduciary duty does not even remotely threaten the integrity of the securities markets or investor confidence. To the extent that the respondent's conduct adversely affects the markets because unsophisticated investors might be deterred from participating, it is important to bear in mind that Zandford was criminally convicted of federal wire fraud and was sentenced to fifty-two months in prison.[104] If the federal wire fraud statute, state criminal law, discipline by the National Association of Securities Dealers,[105] actions by state securities administrators,[106] and private damage actions, not to mention summary dismissal from employment and lifetime banishment from the securities industry, do not provide deterrence to this conduct, it is unlikely that an SEC enforcement action under Rule 10b-5 would. In short, a remedy was not needed under the Exchange Act to address the evils inherent in Zandford's conduct, nor was a remedy needed to realize the purposes of the Act. The limitations expressed in *Santa Fe* do not surface in the Court's opinion. Instead, the more expansive decision in *O'Hagan* is the guiding light of the opinion. Consequently, conduct arguably beyond the reach of section 10(b) is now squarely within it.

C. Wharf

Of the four Supreme Court cases considered here, only *Wharf* involved a private damage action under the securities laws.[107] In *Wharf*, the plaintiff had an oral contract with the defendant, which, under certain circumstances, entitled the plaintiff to purchase a ten percent interest in a business of the defendant's. When the plaintiff sought to exercise its contractual rights, the defendant refused to perform. The plaintiff brought an action under the federal securities laws, claiming that it had purchased an option from the defendant and that the defendant had acted fraudulently in failing to disclose that it had intended not to honor plaintiff's rights under the option.[108] Affirming the lower court, the Supreme Court held that an oral option is enforceable and that defendant's

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102. *Id.* at 822.

103. *Id.* at 819; *Bankers Life*, 404 U.S. at 6. The Court also indicated that it would defer to the SEC under the principle of *Chevron v. Natural Resources Defense Council*, 467 U.S. 837 (1984), and found that section 10(b) was ambiguous and that the SEC's interpretation was reasonable.

104. *Zandford*, 535 U.S. at 816.

105. *See* Brief of NASD Regulation, Inc. as Amicus Curiae in Support of Petitioner at 15, SEC v. Zandford, 535 U.S. 813 (2001) (No. 01-147), 2001 WL 1663774 ("[I]t is undoubtedly true that NASD Regulation would have authority to bring disciplinary proceedings against [Zandford] for misappropriating his client's assets . . . .").

106. *See, e.g.*, MD. CODE ANN., CORPS. & ASS'NS § 11-417 (West 2003).

107. Wharf (Holdings) Ltd. v. United Int'l Holdings, Inc., 532 U.S. 588 (2001).

108. *Id.* at 590.

"secret reservation" amounted to an actionable misrepresentation.[109]

As in the other cases discussed here, the result in *Wharf* is defensible. Technically, the plaintiff's contractual right to purchase a ten percent interest in the defendant could be characterized as an option, and, clearly, an option is included within the definition of a security.[110] Less clear is the Court's conclusion that the "secret reservation" amounted to fraud.[111] One might question whether the defendant had a duty, under the federal securities laws, to disclose its intentions to the plaintiff, with whom it was dealing at arm's length. In other circumstances, the Court has said that a person does not commit securities fraud by failing to disclose material, nonpublic information unless he or she has an independent duty to the other party to the transaction to make the disclosure.[112] In other words, mere possession of "inside information" is insufficient to trigger a disclosure obligation. Without citing this line of decisions, the Court supported its conclusion with a reference to the Restatement (Second) of Torts: "Since a promise necessarily carries with it the implied assertion of an intention to perform[,] it follows that a promise made without such an intention is fraudulent."[113]

What is missing from the *Wharf* opinion is a consideration of the broader issue of whether this sort of transaction *ought* to be covered by the federal securities laws. It is not as though the Court had no choice but to recognize federal jurisdiction in this case. The definition of "security" is prefaced by the phrase "unless the context otherwise requires,"[114] and this case is one in which the Court might have considered the context. In *Marine Bank v. Weaver*,[115] for instance, the Court held that neither a certificate of deposit issued to the plaintiff by a federally insured bank nor a profit sharing arrangement entered into between the bank's borrower and the plaintiff were securities because, in each instance, the context suggested otherwise.[116] As to the certificate of deposit, the Court rejected the lower court conclusion that the certificate was indistinguishable from other long-term debt obligations by noting that unlike other long-term debt, a certificate of deposit issued by a federally regulated bank was "virtually guaranteed" by the FDIC.[117] The "abundant" protection that accrues to bank certificate holders makes it "unnecessary to subject issuers [of the certificates] to liability under the antifraud provisions of the federal securities laws."[118]

As to the profit sharing arrangement, which entitled the plaintiff to a share

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109. *Id.* at 596.

110. 15 U.S.C. § 77b(a)(1) (2000).

111. *Wharf*, 532 U.S. at 597.

112. Chiarella v. United States, 445 U.S. 222, 234-35 (1980).

113. *Wharf*, 532 U.S. at 596 (quoting RESTATEMENT (SECOND) OF TORTS § 530, cmt. c (1976)) (alteration in original).

114. 15 U.S.C. §77b(a) (2000).

115. 455 U.S. 551 (1982).

116. *Id.* at 560-61.

117. *Id.* at 558.

118. *Id.* at 559.

of the borrower's profits, plus a fixed sum each month and certain other benefits,[119] the Court relied on the unique and private nature of the agreement: "[T]he [borrowers] distributed no prospectus to the [plaintiffs] or to other potential investors, and the unique agreement they negotiated was not designed to be traded publicly."[120] This, of course, describes the arrangement in *Wharf* as well. While *Marine Bank* may be an easier case than *Wharf* for denying the applicability of the federal securities laws, it at least compels a consideration of a context exception. The oral contract in *Wharf* may not, in the words of *Marine Bank*, be "commonly considered to be securities in the commercial world,"[121] and it was not offered to other investors. Most importantly, the defendant's default in *Wharf* appears to be indistinguishable from a garden-variety breach of contract or, possibly, the common law tort of deceit. A Court sensitive to issues of federalism would at least have explored the ramifications of its decision in this light. Instead, a simple state law cause of action is now within the federal securities laws.

D. Edwards

Like *Wharf*, *Edwards* is a case that received short shrift in the Supreme Court, and undeservedly so. *Edwards* involved a payphone leasing business.[122] The defendant, through independent distributors, sold payphones to investors and offered them a site lease, a five-year leaseback and management agreement, and a buyback agreement. The investors received a fixed return under the leaseback agreement, amounting to fourteen percent of the purchase price. The arrangement had the trappings of many other investments,[123] and the Court had little trouble finding that the investors had purchased a type of security known as an investment contract.[124] Thus, the district court had jurisdiction under the federal securities laws to adjudicate the SEC's petition for an injunction.[125]

The case centered on the Court's venerable decision in *SEC v. W.J. Howey Co.*,[126] where the Court stated that an investment contract consists of: "an investment of money in a common enterprise with profits to come solely from the

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119. Subject to the borrower's discretion, the plaintiffs could use the barn and pasture held by the borrower's corporation, and the plaintiffs had the right to veto future borrowing by the corporation. *Id.* at 560.

120. *Id.*

121. *Id.* at 559.

122. SEC v. Edwards, 540 U.S. 389 (2004).

123. *See, e.g.*, Wash. Square Sec., Inc. v. Aune, 385 F.3d 432 (4th Cir. 2004); *In re* Alpha Telecom, Inc., No. CV01-1283-PA, 2004 WL 3142555 (D. Or. Aug. 18, 2004); Hornor, Townsend & Kent, Inc. v. Hamilton, No. CIV.A.1:02-CV-2979J, 2003 WL 23832424 (N.D. Ga. Sept. 29, 2003); Leroy v. Paytel III Mgmt. Ass'n, Inc., No. 91-CIV-1933, 1992 WL 367090 (S.D.N.Y. Nov. 24, 1992); State *ex rel.* Miller v. Pace, 677 N.W.2d 761 (Iowa 2004); State v. Justin, 779 N.Y.S.2d 717 (Sup. Ct. 2003).

124. *Edwards*, 540 U.S. at 397.

125. *Id.*

126. 328 U.S. 293 (1946).

efforts of others."[127] The Eleventh Circuit had concluded that this scheme was not an investment contract because the investors were not looking to the business's profits for a return; rather, they were promised a fixed rate of return.[128] Moreover, that court ruled, because the investors were promised a fixed return, they were not dependent on anyone's efforts:

> [T]he determining factor is the fact that the investors were entitled to their lease payments under their contracts with ETS. Because their returns were contractually guaranteed, those returns were not derived from the efforts of Edwards or anyone else at ETS; rather, they were derived as the benefit of the investors' bargain under the contract.[129]

The Eleventh Circuit's decision was highly questionable. It narrowly read the Supreme Court's earlier decision in *United Housing Foundation, Inc. v. Forman*,[130] where in referring to the "profit" test of *Howey*, the Court had suggested that profits meant capital appreciation or earnings.[131] It would be nonsensical to so limit the concept of an "investment contract" and the Supreme Court correctly reversed the appellate court on that issue. But what makes *Edwards* worthy of comment is that the Court did not discuss the second element of *Howey*—the requirement that there be a *common enterprise*.[132] Here, apparently, each investor entered into separate contracts with Edwards's companies. The invested funds were apparently not pooled into a common fund.[133] Rather, there was only what some courts have referred to as "vertical commonality"[134]: each investor's success was dependent on the success or, at least the efforts, of the promoter.[135] The problem with concluding that vertical

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127. *Id.* at 301.

128. SEC v. ETS Payphones, Inc., 300 F.3d 1281, 1284-85 (11th Cir. 2002), *rev'd sub nom.* SEC v. Edwards, 540 U.S. 389 (2004).

129. *Id.* at 1285.

130. 421 U.S. 837 (1975).

131. *Id.* at 852.

132. *Howey*, 328 U.S. at 301.

133. Judge Lay, concurring in the appellate court decision, observed the lack of pooling of funds. *ETS Payphones*, 300 F.3d at 1287 (Lay, J., concurring) ("In the present case, there was no pooling of money in a common venture . . . .").

134. For a note on the meaning of commonality, see Rodney L. Moore, Note, *Defining an "Investment Contract": The Commonality Requirement of the* Howey *Test*, 43 WASH. & LEE L. REV. 1057 (1986).

135. Steinberg summarizes two views of vertical commonality, succinctly set forth in *Mechigian v. Art Capital Corp.*, 612 F. Supp. 1421, 1425-26 (S.D.N.Y. 1985):

> There is a split in the courts that have applied the "vertical commonality" approach regarding precisely what is necessary to satisfy this standard. The courts applying the more restrictive definition state that "vertical commonality" exists where "the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties." SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 482 n.7 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973). Thus, the Ninth

commonality is sufficient is that it reads the second prong out of the *Howey* test; vertical commonality simply means the investor's fortunes were somehow dependent on the efforts (or, in some jurisdictions, the fortunes) of the promoter. This dependency is, of course, inevitable in virtually any investment and, in any event, is the third prong of the *Howey* test. Moreover, the requirement of horizontal commonality links the definition of a security to the investor's participation in broader capital markets—the focus of the federal securities laws.[136]

The question of whether vertical commonality is sufficient to satisfy the *Howey* test has divided the circuits,[137] and prompted Justice White to urge the granting of certiorari in a 1985 case.[138] Moreover, the Court's 1982 decision in *Marine Bank v. Weaver*[139] has been read as implying that only horizontal commonality will satisfy the definition of a security.[140] With that background, and given the facts of *Edwards*, it is surprising that the Court did not address the commonality issue. What can be made of this? One answer is that the Court was implicitly deciding that, despite *Marine Bank*, vertical commonality is sufficient to satisfy the definition. Another possibility is that the Court was removing the commonality test in its entirety; a security is then defined as an investment of money with the expectation of an investment return (in the form of a share of the

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> Circuit appears to require merely that there be a "direct relation between the success or failure of the promoter and that of his investors." Mordaunt v. Incomco, 686 F.2d 815, 817 (9th Cir. 1982), *cert. denied*, 469 U.S. 1115 (1985). However, absent such a direct relation, the Ninth Circuit will not find "vertical commonality."
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> . . .
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> A broader definition of "vertical commonality" seems to have been articulated by the Fifth Circuit which has held that "the requisite commonality is evidenced by the fact that the fortunes of all investors are inextricably tied to the efficacy of the [promoter's efforts]." SEC v. Continental Commodities, 497 F.2d 516, 522 (5th Cir. 1974) (quoting SEC v. Koscot Interplanetary, Inc., 497 F.2d 473, 479 (5th Cir.1974)). Thus, rather than requiring a tie between the fortunes of the investors and the *fortunes* of the promoters, as is necessitated under the restrictive definition of "vertical commonality," the broader definition merely requires a link between the fortunes of the investors and the *efforts* of the promoters. Judge Robert J. Ward of this court has noted that the application of this broader definition of "vertical commonality" essentially eliminates the "common enterprise" prong of the *Howey* test because the only inquiry required is whether the success or failure of the investment is dependent upon the promoter's efforts—i.e. the third prong of the *Howey* test. Savino v. E.F. Hutton & Co., Inc., 507 F. Supp. 1225, 1237-38 n.11 (S.D.N.Y. 1981).

MARC I. STEINBERG, SECURITIES REGULATION 42-43 (4th ed. 2004) (citations altered). *See generally id.* and authorities cited therein.

136. *ETS Payphones*, 300 F.3d at 1287 (Lay, J., concurring).

137. *See* STEINBERG, *supra* note 135.

138. Mordaunt v. Incomco, 469 U.S. 1115, 1116 (1985) (White, J., dissenting).

139. 455 U.S. 551 (1982).

140. STEINBERG, *supra* note 135, at 76-77.

profits, capital appreciation, or a fixed return) as a result of the efforts of others. Both explanations are troubling, however, in view of the careful analysis given by the Court in previous cases raising the definition of a security.[141] Clearly, though, the Court was unwilling to define away the SEC's power to bring an enforcement action under these facts. This is understandable considering that, according to the Commission's complaint, more than $300 million was raised from over 10,000 investors.[142] This fraud (if it was one)[143] had national implications and, perhaps, was sufficient to invoke the protections of the federal securities laws. On the other hand, the Court has previously noted that the federal securities laws were not intended to address all frauds[144]—only those involving securities. While the definition of a security is broad, it is not without boundaries, and the Court's decision in *Edwards* failed to consider one of those important boundaries. There is a certain judicial arrogance in this; the fine distinctions made in earlier cases have been rendered unimportant, unworthy of even a passing mention. The decision can thus be characterized as one preferring a national solution—in this case under the securities laws—to alternative approaches.

III. FEDERALISM AND CORPORATE LAW

In each of these cases, the Court elected an expansive view of the federal securities laws that threatens displacement of state law.[145] There has been no

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141. In addition to *Howey* and *Edwards*, the Court has decided numerous cases over the years regarding the definition of a "security." *E.g.*, Reves v. Ernst & Young, 494 U.S. 56, 58 (1990) (finding short term notes to be securities); Landreth Timber Co. v. Landreth, 471 U.S. 681, 697 (1985) (rejecting the "sale of business" doctrine); Marine Bank v. Weaver, 455 U.S. 551, 555 (1982) (finding that neither bank certificate of deposit nor unique profit sharing arrangements are securities); Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 570 (1979) (holding interest in noncontributory pension plan is not a security); United Hous. Found., Inc. v. Forman, 421 U.S. 837, 860 (1975) (deciding stock in a housing cooperative is not a security); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 349 (1943) (finding that oil leases, as structured, were investment contracts).

142. SEC v. Edwards, 540 U.S. 389, 391 (2004).

143. There was no indication in either of the published opinions that Edwards was running a scam. It could well have been the case, as Judge Lay noted in his concurring opinion in the court of appeals, that "ETS made a good faith effort to run a legitimate business." SEC v. ETS Payphones, Inc., 300 F.3d 1281, 1288 (11th Cir. 2002), *rev'd sub nom.* SEC v. Edwards, 540 U.S. 389 (2004).

144. *See, e.g.*, *Marine Bank*, 455 U.S. at 556 ("[W]e are satisfied that Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud.").

145. An expansive view of federal legislation in general, as discussed in this section, has an analog in the Court's interpretation of individual liberties, guaranteed by the Constitution, against attempts by the states to further competing interests. For instance, in *R.A.V. v. City of St. Paul*, 505 U.S. 377 (1992), the Court's interpretation of freedom of speech invalidated the state's attempt to regulate the use of "fighting words," which had been regarded as a form of unprotected speech. *Id.* at 381. For a discussion of several recent cases demonstrating the same tendency, noting

concern that these cases represent a rejection of federalism, despite the contemporaneous decisions in *United States v. Lopez*,[146] which held unconstitutional the Gun-Free School Zones Act of 1990, and *United States v. Morrison*,[147] which held unconstitutional the Federal Violence Against Women Act. Each of these cases suggested a profound commitment to federalism. *Lopez* and *Morrison* raised the question as to whether there were limits to Congress's power when acting under the Commerce Clause; the Court said that there were. In the securities laws cases considered here, there is no question that Congress has the power to regulate securities transactions occurring in interstate commerce; rather, the issue is how its legislation should be interpreted.[148]

The Court has, in the past, demonstrated a sensitivity to expansive readings of federal legislation, observing "[t]hat an activity is of local character may help in a doubtful case to determine whether Congress intended to reach it."[149] This dictum from its 1942 decision in *Wickard v. Filburn*[150] reflects a judicial sentiment absent from the Rule 10b-5 cases considered here; the *Wickard* dictum suggests that if Congress intended to regulate a local activity it would do so unambiguously.[151] Can it be said that section 10(b) clearly indicates an intention to reach the breach of fiduciary duty in *O'Hagan*, the misappropriation of client funds in *Zandford*, the breach of contract in *Wharf*, or, with respect to *Edwards*, that the definition of a security includes the contractual arrangements present there?

The dictum in *Wickard* seems not to have had a great deal of influence in Supreme Court jurisprudence. *Wickard* is itself an example of an expansive reading of a federal statute; the Court interpreted the Agricultural Adjustment Act to limit the ability of a farmer to grow wheat for personal consumption.[152]

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particularly how the Court's most conservative Justices prefer national interests to state interests, see NAGEL, *supra* note 28, at 27.

146. 514 U.S. 549, 602 (1995) (holding Congress does not have power under the Commerce Clause to regulate firearm possession in local schools).

147. 529 U.S. 598, 627 (2000).

148. One could be so bold as to raise the question of whether, at least in *Zandford*, interstate commerce was involved. The case seems local if one views it as a simple theft of money by a Maryland broker from a Maryland brokerage account owned by Maryland residents. Interstate commerce enters into the case because the securities were sold on a national securities exchange and the funds were transferred between New York and Maryland. These facts, of course, were tangential to the theft in question, but sufficient to satisfy the jurisdictional elements of the Exchange Act. Whether these jurisdictional elements were satisfied was not an issue in the case.

149. Wickard v. Filburn, 317 U.S. 111, 124 (1942).

150. *See* Fed. Trade Comm'n v. Bunte Bros., 312 U.S. 349, 351 (1941) ("But bearing in mind that in ascertaining the scope of congressional legislation a due regard for a proper adjustment of the local and national interests in our federal scheme must always be in the background, we ought not to find in § 5 radiations beyond the obvious meaning of language unless otherwise the purpose of the Act would be defeated.").

151. *Wickard*, 317 U.S. at 124.

152. *See* Jim Chen, *Filburn's Legacy*, 52 EMORY L.J. 1719, 1747 (2003) (suggesting that, in

In *Wickard*, however, it may have been the case that Congress intended to reach this activity because, in the aggregate, the production of wheat by farmers for personal consumption could have a substantial economic effect on the market for wheat, the object of the legislation.[153] By contrast, the Exchange Act was concerned with the national market for securities; the oral "option contract" between the parties in the *Wharf* case had at best only a tenuous relationship to that market. The constitutionality of applying the Exchange Act to the facts of *Wharf* was not even an issue in the case.

An expansive reading of Congress's power under the Commerce Clause is a consistent theme, until perhaps recently, of the Court's post-New Deal jurisprudence. The Court upheld the Civil Rights Act of 1964, which prohibited racial discrimination in certain places of public accommodation, as a valid exercise of Congress's power, over challenges that the regulated activity was not interstate commerce.[154] In *Heart of Atlanta Motel*,[155] for instance, the Court held that the renting of motel rooms was commerce that concerns more than one state and thus prohibiting racial discrimination in the renting of rooms was within Congress's power.[156]

While the Civil Rights Act was intended to reach racial discrimination in such places, other cases reflected the Court's willingness to interpret federal legislation to reach activities that were likely not the intent of congressional legislation. A typical case was *Goldfarb v. Virginia State Bar*,[157] in which the Court held that the Sherman Act reached the actions of a state bar that published a fee schedule that operated as price floor on legal fees. *Goldfarb* and other cases[158] have suggested to many commentators that Congress's power under the

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view of the Court's modern federalism cases, *Filburn* may represent a high water mark under the Commerce Clause).

153. One might explain *Wickard* as the Court's concession to practical necessity. To assure the success of its attempt to regulate the market for wheat, Congress had to regulate all production. *See* Robert F. Nagel, *The Future of Federalism*, 46 CASE W. RES. L. REV. 643, 651 (1996) ("In [*Wickard v. Filburn*], the practical necessities of administering a national program were a reason for devaluing the proposition that there is some regulatory authority that is beyond the power of Congress.").

154. Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 278 (1964).

155. *Id. C.f.* Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 406 (2004) (finding that section 2 of the Sherman Act did not reach Verizon's refusal to enter into contracts with competitors, as required by the Telecommunications Act of 1996, in part because the Telecommunications Act provided that nothing in it "shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws." (quoting 47 U.S.C. § 152 (2000)).

156. *Heart of Atlanta Motel*, 379 U.S. at 278. See also *Katzenbach v. McClung*, 379 U.S. 294, 305 (1964), a companion case to *Heart of Atlanta Motel*, which upheld the applicability of the Act to restaurants.

157. 421 U.S. 773 (1975).

158. *E.g.*, Perez v. United States, 402 U.S. 146, 156-67 (1971) (upholding the constitutionality of the federal anti-loansharking statute to a private, intrastate loan). As in the civil rights cases, this case involved the finding of constitutionality of a federal statute to a situation to which it was

Commerce Clause was virtually limitless[159] until several recent cases upset conventional wisdom. Examples of these "new federalism" cases are *United States v. Lopez* and *United States v. Morrison*. In *Lopez*, decided in 1995, the Court held that the Gun-Free School Zones Act of 1990,[160] which made it a federal offense "for any individual knowingly to possess a firearm . . . at a place the individual knows, or has reasonable cause to believe, is a school zone,"[161] was unconstitutional. The Court found that the Act "neither regulates a commercial activity nor contains a requirement that possession be connected in any way to interstate commerce."[162] The Act, therefore, exceeded Congress's power under the Commerce Clause.

In *Morrison*, the Court, relying heavily on *Lopez*, held that the Violence Against Women Act of 1994[163] was also an unconstitutional exercise of Congress's power under the Commerce Clause.[164] This Act sought to afford a private civil remedy for persons who were the victims of "crimes of violence motivated by gender."[165] The Court found that the necessary effects on interstate commerce were simply not present, at least when the regulated activity is noneconomic in nature.[166]

Lopez and *Morrison* raise two questions for our purposes. First, do they represent, as some scholars have suggested, a new attitude of the Court with respect to the powers of Congress under the Commerce Clause?[167] Second, of

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intended to apply.

159. *E.g.*, Ann Althouse, *The* Alden *Trilogy: Still Searching for a Way to Enforce Federalism*, 31 RUTGERS L.J. 631, 658 (2000); Richard A. Epstein, *Constitutional Faith and the Commerce Clause*, 71 NOTRE DAME L. REV. 167, 173 (1996).

160. 18 U.S.C. § 922(q) (2000).

161. *Id.* § 922(q)(2)(A).

162. United States v. Lopez, 514 U.S. 549, 551 (1995). The Court did not rebut evidence presented by the dissent that there were effects on commerce. Thus, *Lopez* might be read as holding that if the statute does not regulate a typically "commercial" activity, the relationship between the regulation and commerce must be direct. For an interesting comment on the case, see Donald H. Regan, *How to Think About the Federal Commerce Power and Incidentally Rewrite* United States v. Lopez, 94 MICH. L. REV. 554 (1995).

163. 42 U.S.C. § 13981 (2000).

164. United States v. Morrison, 529 U.S. 598, 601 (2000). Interestingly, the states themselves, the supposed beneficiaries of federalism, did not support the outcome that the Court reached in *Morrison*. Only one state supported a pro-federalism position before the Court, while thirty-five states took the position in amici briefs that Congress had the power under the Commerce Clause to provide a federal tort remedy for gender-based violence. *See* Michael S. Greve, *Business, the States, and Federalism's Political Economy*, 25 HARV. J.L. & PUB. POL'Y 895, 910 (2002).

165. 42 U.S.C. § 13981 (2000).

166. *Morrison*, 529 U.S. at 617-18 ("We . . . reject the argument that Congress may regulate noneconomic, violent criminal conduct based solely on that conduct's aggregate effect on interstate commerce. The Constitution requires a distinction between what is truly national and what is truly local.") (citing *Lopez*, 514 U.S. at 568).

167. *E.g.*, MICHAEL S. GREVE, REAL FEDERALISM: WHY IT MATTERS, HOW IT COULD HAPPEN

what relevance are those cases to the federal securities laws, inasmuch as they invalidated acts of Congress while the constitutionality of the federal securities laws were well established? As to the first question, this author does not believe that *Lopez* and *Morrison* represent a sea change in constitutional adjudication and, therefore, the Court's expansive reading of the Rule and other sections of the federal securities laws is likely to be unaffected. Professor Nagel, in his 2001 book, *The Implosion of American Federalism*, took a longer view of the role of the judiciary in preserving notions of federalism. He observed that "[t]he terms of constitutional debate, as well as a sober assessment of the outcomes of judicial cases, indicate that federal judges do not and cannot appreciate a robust federalism."[168] Decisions in the past few years discussed in this Article confirm his observation.

As to the second question, if *Lopez* and *Morrison* were harbingers of a new jurisprudence, their effect should be felt in the interpretation of federal statutes.[169] That is, the Court should be sensitive to an interpretation, even

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(1999); Steven G. Calabresi, *A Government of Limited and Enumerated Powers: In Defense of* United States v. Lopez, 94 MICH. L. REV. 752 (1995); Keith E. Whittington, *Dismantling the Modern State? The Changing Structural Foundations of Federalism*, 25 HAST. CONST. L.Q. 483 (1998).

168. NAGEL, *supra* note 28, at 11; *see, e.g.*, Allison H. Eid, *Federalism and Formalism*, 11 WILLIAM & MARY BILL RGTS. J. 1191, 1229 (2003) (observing that "[t]he federalism 'revival' is a limited one").

169. The effect should also be reflected in a more robust reading of the Eleventh Amendment: "[t]he judicial power of the United States shall not be construed to extend to any [suit], commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens of Subjects of any Foreign States." U.S. CONST. amend. XI. Indeed, several recent cases have suggested that the Court vigorously enforces the federalism principles reflected in the Eleventh Amendment. *See, e.g.*, Bd. of Tr. of Univ. of Ala. v. Garrett, 531 U.S. 356, 374 (2001) (finding that Title I of the American with Disabilities Act unconstitutionally abrogated states' immunity from suit); Kimel v. Fla. Bd. of Regents, 528 U.S. 62, 91 (2000) (deciding that states are not subject to suit under the Age Discrimination Act of 1967 despite provision in the Act subjecting states to suit); Alden v. Maine, 527 U.S. 706, 712 (1999) (holding that sovereign immunity bar announced in a prior decision applies to lawsuits against states in state court); Coll. Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 691 (1999) (invalidating the Trademark Remedy Clarification Act, which had subjected the states to federal lawsuits brought by business that competed with the states complaining of false and misleading advertising); Fla. Prepaid Postsecondary Educ. Expense Bd. v. Coll. Sav. Bank, 527 U.S. 627, 647 (1999) (invalidating Patent and Plant Variety Protection Remedy Clarification Act, which had expressly abrogated the states' sovereign immunity from claims of patent infringement); Seminole Tribe of Fla. v. Florida, 517 U.S. 44, 65 (1996) (finding that Congress cannot abrogate a state's Eleventh Amendment immunity when acting under its commerce power).

Cases from the last two terms, however, reflect restraint. *See* Tennessee v. Lane, 541 U.S. 509, 531 (2004) (holding that Congress acted within its powers in subjecting states to liability for monetary damages under Title II of the American with Disabilities Act); Nev. Dep't of Human Res. v. Hibbs, 538 U.S. 721, 740 (2003) (finding the State of Nevada subject to suit under the Family

though constitutional, that stretches a statute beyond its apparent intent, which is, of course, the *Filburn* dictum. But the post-*Lopez* cases do not support this principle. Rather, the modern securities laws cases discussed above suggest an expansive reading of the federal statutes regulating business.

The Court's broad reading of the federal securities laws over the past several years is matched by the Court's interpretation of the Federal Arbitration Act ("FAA").[170] Unlike the Court's varied view of the federal securities laws, however, the Court has more consistently taken an expansive view of the FAA. In *Southland Corp. v. Keating*,[171] for instance, Chief Justice Berger, writing for six members of the Court in 1984, ruled that the FAA established a substantive rule of law that arbitration agreements are enforceable in state courts,[172] despite the impressive legislative history assembled by Justice O'Connor that suggested otherwise.[173] At issue was a California statute[174] protecting franchisees that, according to the California Supreme Court,[175] entitled franchisees to litigate their claims under the law in state court. The California court voided arbitration clauses in franchise agreements. The Supreme Court reversed, thus deciding that the FAA preempted the California statute. That Congress in 1925 intended to create a substantive rule that state courts would have to enforce arbitration agreements, even in the face of contrary state law, seems on its face at least startling, if not incredible.[176] Justice Stevens, concurring in part, frankly conceded as much.[177]

The expansive reading of the FAA reflected in *Southland* was matched during the period of "heightened sensitivity" to federalism in *Circuit City Stores Inc. v. Adams*,[178] decided in 2001, well after *Lopez* was decided and a year after *Morrison* came down. At issue in *Circuit City* was whether the FAA covered

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Medical Leave Act of 1993, as Congress validly abrogated the states' Eleventh Amendment rights by invoking its powers under Section 5 of the Fourteenth Amendment).

170. 9 U.S.C. §§ 1-307 (2000).

171. 465 U.S. 1 (1984).

172. *Id.* at 16.

173. *Id.* at 21 (O'Connor, J., dissenting).

174. CAL. CORP. CODE § 31512 (West 2005).

175. Keating v. Sup. Ct. Alameda County, 645 P.2d 1192, 1203-04 (Cal. 1982).

176. *See* Laura Kaplan Plourde, *Analysis of* Circuit City Stores, Inc. v. Adams *in Light of Previous Supreme Court Decisions: An Inconsistent Interpretation of the Scope and Exemption Provisions of the Federal Arbitration Act*, 7 J. SMALL & EMERGING BUS. L. 145, 165 (2003) ("[I]n 1924, the year prior to the passage of the FAA, congressional Commerce Clause authority was limited to items or persons 'engaged in commerce.' Further, the narrow understanding of Commerce Clause authority continued through the drafting of the FAA.") (citations omitted).

177. *Southland*, 465 U.S. at 17 (Stevens, J., concurring in part and dissenting in part) ("Although Justice O'Connor's review of the legislative history of the [FAA] demonstrates that the 1925 Congress that enacted the statute viewed the statute as essentially procedural in nature, I am persuaded that intervening developments in the law compel the conclusion that the Court has reached.").

178. 532 U.S. 105 (2001).

ordinary employment contracts. The FAA generally makes arbitration agreements "evidencing a transaction involving commerce . . . valid, irrevocable and enforceable," but exempts "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce."[179] While a strong argument can be made that employment agreements are not transactions involving commerce,[180] and thus are not within the scope of the FAA, earlier precedent foreclosed this question.[181] Thus, *Circuit City* focused on whether the exemptive provision included all employment agreements "involving commerce," or only those agreements involving transportation workers, as several appellate courts had previously held.[182] A closely divided Court opted for the latter interpretation, giving a narrow reading to the exemptive provision.[183]

The liberal Justices dissented, probably reflecting a discomfort with the notion of relegating employees to arbitration where, presumably, employers have an advantage. The conservative Justices, on the other hand, were seemingly protective of the freedom of contract, such as it is in these cases.[184] Scant attention was paid by either side to whether this essentially private transaction—a garden variety employment contact between a "sales counselor" and a retailer of consumer electronics—is so "local" in character that, absent clear congressional intention to the contrary, the FAA was unlikely to cover this agreement.[185] No serious inquiry into congressional intent can take place without considering what Congress believed its Commerce Clause power was in 1925 and whether, in the political climate of the time, Congress sought to encroach on

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179. 9 U.S.C. §§ 1-2 (2000).

180. *See Circuit City*, 532 U.S. at 124 (Stevens, J., dissenting) ("If we were writing on a clean slate, there would be good reason to conclude that . . . the phrase . . . 'contract evidencing a transaction involving commerce' was [not] intended to encompass employment contracts.").

181. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20 (1991).

182. *See* McWilliams v. Logicon, Inc., 143 F.3d 573 (10th Cir. 1998); O'Neil v. Hilton Head Hosp., 115 F.3d 272 (4th Cir. 1997); Pryner v. Tractor Supply Co., 109 F.3d 354 (7th Cir. 1997); Cole v. Burns Int'l Sec. Servs., 105 F.3d 1465 (D.C. Cir. 1997); Rojas v. TK Commc'ns, Inc., 87 F.3d 745 (5th Cir. 1996); Asplundh Tree Expert Co. v. Bates, 71 F.3d 592 (6th Cir. 1995); Erving v. Va. Squires Basketball Club, 468 F.2d 1064 (2d Cir. 1972); Dickstein v. DuPont, 443 F.2d 783 (1st Cir. 1971); Tenney Eng'g Inc. v. United Elec., Radio & Mach. Workers, 207 F.2d 450 (3d Cir. 1953).

183. *Circuit City*, 532 U.S. at 123-24.

184. The dissenters argued that the exemptive provision, added to the Act in response to concerns expressed by organized labor, especially in the transportation industry, was intended to make clear that employment agreements were not covered by the Act. *Id.* at 126-28. Thus, at least arguably, Congress was making a concession to labor involved in the transportation industry, but the rest of the exemptive provision was not a concession to labor interests, as there were doubts that Congress could regulate private employment contracts outside of the transportation industry.

185. *See also* Citizens Bank v. Alafabco, Inc., 539 U.S. 52, 53 (2003) (holding that debt-restructuring agreements executed in Alabama by Alabama residents satisfy the FAA's "involving commerce" test).

this traditional area of state regulation. The conservative wing of the Court was, ironically, not more sensitive to this concern. This indifference to the states' jurisdiction also reflected in the securities laws cases, makes *Lopez* and *Morrison* seem more like outliers in a judicial agenda of expanding federal power, even at the risk of offending congressional intent.[186]

Support for this view is evident in the Court's 2000 decision in *Geier v. American Honda Motor Co.*[187] This case decided that a state law tort claim was preempted by a regulation adopted by the Department of Transportation mandating the phase-in of airbags by car manufacturers.[188] Although defendant Honda was in compliance with the phase-in requirements, plaintiff claimed that failure to include a driver side airbag in his 1987 Honda constituted negligence under state common law. The Court upheld dismissal of the complaint, reasoning that the plaintiff's claim was in conflict with the DOT standard, despite a savings clause in the federal statute that provided: "Compliance with a motor vehicle safety standard prescribed under this chapter does not exempt a person from liability at common law."[189] This savings clause was the basis for a strong dissent by Justice Stevens, joined by Justices Souter, Ginsburg, and Thomas.[190] Again, with some exceptions, the conservative Justices tend to favor the extension of federal power, with the liberal Justices in dissent. The real fault line, however, at least for most of the Court, may be on the question of whether a state law negligence claim with potentially significant damages should be allowed to go forward when a plausible case for preemption exists.[191] In any case, this Court has been aggressive in finding federal preemption,[192] as

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186. The Court's protective reading of the FAA carried the day in another case from the same term, *PacifiCare Health Systems, Inc. v. Book*, 538 U.S. 401 (2003). In *PacifiCare*, the issue was whether a provision in the arbitration agreement that precluded punitive damages rendered the agreements unenforceable because the plaintiffs claimed relief under the Racketeer Influenced and Corrupt Organization Act (RICO). RICO entitled successful plaintiffs to treble damages, which they argued the arbitrators would be unable to award. Not so, ruled the Supreme Court, as the arbitrator may find that such damages are remedial in nature. *Id.* at 405-06. In any case, the issue was one for the arbitrator and not the courts to resolve. *Id.* at 407. Similarly, in *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 81 (2002), the Court decided that arbitrators should decide whether arbitration was time-barred.

187. 529 U.S. 861 (2000).

188. The regulation was adopted pursuant to the National Traffic and Motor Vehicle Safety Act of 1966, 49 U.S.C. §§ 30101-30127 (2000).

189. 49 U.S.C. § 30103(e) (2000).

190. *Geier*, 529 U.S. at 886.

191. Some commentators have explained that Justices who favor a stronger form of federalism are also committed to deregulation, which is often furthered by a liberal preemption doctrine. *See, e.g.*, Richard H. Fallon, Jr., *The "Conservative" Paths of the Rehnquist Court's Federalism Decisions*, 69 U. CHI. L. REV. 429, 462, 471 (2002); Jonathan D. Varat, *Federalism and Preemption in October Term 1999*, 28 PEPP. L. REV. 757, 767 (2001).

192. *See, e.g.*, Susan Raeker-Jordan, *A Study in Judicial Sleight of Hand: Did* Geier v. American Honda Motor Co. *Eradicate the Presumption Against Preemption?*, 17 BYU J. PUB. L.

suggested by several other cases from the same term.[193] Abstract notions of federalism and the respect for state law that it entails seem to be far less of an issue, despite the fact that the Court has, on several occasions, embraced a presumption against preemption when state police powers are at issue.[194]

The Court's broad reading of the Constitution is similar to the Court's broad reading of federal statutes, evident in its evolving jurisprudence on the question of punitive damages.[195] Once thought to be the province of state law,[196] in recent

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1, 8 (2002) ("Most blatantly, the Supreme Court's five-member majority ignored the long-standing presumption against preemption . . . ."); Comment, *Federal Statutes and Regulations*, 114 HARV. L. REV. 339, 339 (2000) ("[In *Geier v. American Honda Motor Co.*], the Court once again chose to disregard the presumption [against preemption].").

193. *E.g.*, Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 371 (2000) (preempting local ordinance requiring boycott of Burma); Norfolk S. Ry. Co. v. Shanklin, 529 U.S. 344, 359 (2000) (preempting state tort liability); United States v. Locke, 529 U.S. 89, 116 (2000); *see also* Lorillard Tobacco Co. v. Reilly, 533 U.S. 525, 571 (2001) (finding that state regulations governing cigarette advertising and sales preempted by Federal Cigarette Labeling and Advertising Act); Egelhoff v. Egelhoff, 532 U.S. 141, 150 (2001) (deciding that state law providing that upon divorce beneficiary designations automatically revoked was preempted by the Employee Retirement Income Security Act of 1974); Buckman Co. v. Plaintiffs' Legal Comm., 531 U.S. 341, 353 (2001) (holding that the Federal Food, Drug, and Cosmetic Act preempts state Fraud-on-the-FDA claims). More recent cases also reflect the Court's willingness to preempt state law. *See* Aetna Health Inc. v. Davila, 542 U.S. 200 (2004) (finding that ERISA preempts state court suits alleging that defendant HMOs failed to exercise ordinary care under the Texas Health Care Liability Act); Engine Mfrs. Ass'n v. S. Coast Air Quality Mgmt. Dist., 541 U.S. 246, 258 (2004) (holding that California rule requiring fleet purchases to meet certain emissions requirements was preempted by Federal Clean Air Act); Pierce County, Wash. v. Guillen, 537 U.S. 129, 148 (2003) (deciding that Federal Hazard Elimination Program's evidentiary privileges apply in state court proceedings as appropriate use of the commerce clause). *But see* Sprietsma v. Mercury Marine, 537 U.S. 51, 69 (2002) (finding that state tort action based on boat manufacturers' failure to provide propeller guards was not preempted by Federal Boat Safety Act of 1971).

194. *E.g.*, Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996) ("In all pre-emption cases, and particularly in those [where] Congress has 'legislated . . . in a field which the States have traditionally occupied,' we 'start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.'") (citations omitted); *see also* Engine Mfrs. Ass'n v. S. Coast Air Quality Mgmt. Dist., 541 U.S. 246, 259-66 (2004) (Souter, J., dissenting); Wis. Pub. Intervenor v. Mortier, 501 U.S. 597, 605 (1991) (applying presumption against preemption to a local regulation).

195. *See* BMW of N. Am., Inc. v. Gore, 517 U.S. 559 (1996). The Court's preference for federal solutions is evident in two other lines of recent cases—those dealing with the removal jurisdiction of the federal courts and the spending power. The removal cases, while seemingly a technical procedural issue, reveal the Court's strong preference for dispute resolution in the federal courts as opposed to state courts. In a 2003 case, *Beneficial National Bank v. Anderson*, 539 U.S. 1 (2003), for instance, the Court ruled that defendant National Bank could remove to the federal courts a claim that only sought relief under state law because federal law (the federal National Bank Act, 12 U.S.C. § 85 (2000)) provided an exclusive remedy for usury, the wrong complained of by

years the Supreme Court has created a federal jurisprudence to limit punitive damages in cases arising under state law. In 1991, the Court held that the Due Process Clause of the Fourteenth Amendment barred excessive punitive damage awards.[197] Within a few years, the Court was earnestly seeking to apply this new interpretation of the Fourteenth Amendment,[198] holding in 1993 that an award of punitive damages "526 times greater than the actual damages awarded by the jury"[199] was constitutional and, in 1996, that a 500 to 1 ratio, under the circumstances of the case, violated the Constitution.[200]

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the plaintiff. *Id.* at 3-4. The case represents an exception to the "well-pleaded complaint rule," under which removal is not permitted unless the complaint expressly alleges a federal claim. *Id.* at 11. *Beneficial* builds and expands on earlier precedent that enlarged removal jurisdiction. *Id.* In short, the majority indicated a distrust for state courts, which ought to dismiss the claim on the basis of federal preemption. *Id.* Apparently fearing that state courts would not act accordingly, the Court established a precedent of removal to the federal courts for resolution of the claim. *Id.*

As to the spending power, see *Sabri v. United States*, 541 U.S. 600 (2004), which upheld under the spending power, a federal statute that proscribed bribery of state and local officials of entities, such as Minneapolis, that received at least $10,000 in federal funds. The Court held so despite the lack of a connection between the federal funds and the alleged bribe, as an element of liability. *Id.* at 605. *See generally* Lynn A. Baker & Mitchell N. Berman, *Getting Off the Dole: Why the Court Should Abandon Its Spending Doctrine, and How a Too-Clever Congress Could Provoke It to Do So*, 78 IND. L.J. 459 (2002) (discussing a loophole in the Court's opinion restricting the spending power that would enable Congress to pass a statute expanding its spending power).

196. Browning-Ferris Indus. of Vt., Inc. v. Kelco Disposal, Inc., 492 U.S. 257 (1989).

197. In *Pacific Mutual Life Insurance Co. v. Haslip*, 499 U.S. 1, 18 (1991), the Court observed that "unlimited jury [or judicial] discretion . . . in the fixing of punitive damages may invite extreme results that jar one's constitutional sensibilities." The Court went on to hold that the Due Process Clause would address those sensibilities and guard against unreasonable awards. *Id.* at 17-24.

198. Many commentators have expressed their disagreement with this interpretation of the Fourteenth Amendment. *See, e.g.*, Steven L. Chanenson & John Y. Gotanda, *The Foggy Road for Evaluating Punitive Damages: Lifting the Haze From the BMW/State Farm Guideposts*, 37 U. MICH. J.L. REFORM 441 (2004) (proposing that highest comparable fine should be the presumptive constitutional limit on a punitive damage award); Laura J. Hines, *Due Process Limitations on Punitive Damages: Why State Farm Won't Be the Last Word*, 37 AKRON L. REV. 779 (2004) (arguing that Court has failed to address several important issues in its punitive damages jurisprudence); Martin H. Redish & Andrew L. Mathews, *Why Punitive Damages Are Unconstitutional*, 53 EMORY L.J. 1 (2004) (arguing that punitive damages as currently structured are unconstitutional); Catherine M. Sharkey, *Punitive Damages as Societal Damages*, 113 YALE L.J. 347 (2003) (arguing for a reformulation of punitive damages as "societal damages").

199. TXO Prod. Corp. v. Alliance Res. Corp., 509 U.S. 443, 453 (1993).

200. BMW of N. Am., Inc. v. Gore, 517 U.S. 559 (1996). The Court established three guideposts for courts reviewing punitive damages to consider: (1) the degree of reprehensibility of the defendant's misconduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases. *Id.* at 575-

The Court's most recent pronouncement, its 2003 opinion in *State Farm Mutual Automobile Insurance Co. v. Campbell*,[201] suggests that federal courts will be active participants in determining the appropriateness of state punitive damage awards. Based on criteria developed in its 1996 decision in *BMW of North America, Inc. v. Gore*,[202] the Court decided that punitive damages awarded by the Utah court were excessive.[203] Addressing the question of the appropriate ratio of punitive damages to compensatory damages, the Court suggested that "in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process."[204] In the following paragraph of the opinion, however, the Court further blurred this already fuzzy standard:

> Nonetheless, because there are no rigid benchmarks that a punitive damages award may not surpass, ratios greater than those we have previously upheld may comport with due process where "a particularly egregious act has resulted in only a small amount of economic damages." . . . The converse is also true, however. When compensatory damages are substantial, then a lesser ratio, perhaps only equal to compensatory damages, can reach the outermost limit of the due process guarantee. The precise award in any case, of course, must be based upon the facts and circumstances of the defendant's conduct and the harm to the plaintiff.[205]

Not surprisingly, this pronouncement drew some dissent, and Justice Scalia wrote: "I am . . . of the view that the punitive damages jurisprudence which has sprung forth from *BMW v. Gore* is insusceptible of principled application . . . ."[206] Given the vague standards that the Court has delineated, Justice Scalia is undoubtedly correct. In any case, the state role in determining punitive damages has been diminished. While this may be a positive for American businesses, at least in the short run, the Court's actions reflect another trend in the preemption of state law, this time based on constitutional principles. Nevertheless, the ability of states to experiment in this area of law, to limit arbitration, or to define fiduciary duties, has been limited by the Court's nationalistic tendencies. Whether these limitations will redound to the benefit of business in the long run is an open question.

CONCLUSION

The modern securities laws cases, in contrast to cases such as *Santa Fe* and *Blue Chip Stamps*, are nearly bereft of concern for state law. There are, of course,

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201. 538 U.S. 408 (2003).

202. 517 U.S. 559 (1996); *see supra* note 200 for those criteria.

203. *State Farm*, 538 U.S. at 409-11.

204. *Id.* at 425.

205. *Id.*

206. *Id.* at 429 (Scalia, J., dissenting).

qualitative differences between the modern cases and the earlier ones discussed here. Arguably, the modern cases neither result in a preemption of state law nor have the potential of interfering with the allocation of power as among the corporate actors—a chief concern in the Court's earlier opinions. But the modern cases have a different, and no less important consequence: as a practical matter, they preempt areas of law traditionally within the province of state law, and endorse the displacement of states as players in the area of business law. Individually, the encroachment of the modern cases is insignificant; collectively, they fit neatly into a pattern of Supreme Court cases that stretches back to the New Deal era and is unbroken by the decisions in *Lopez* and *Morrison*.[207]

One might ask, what of this? Arguably, there are some real and potential consequences to this preference for a national solution. Imposing a national solution to a problem, such as the misappropriation of confidential information addressed in *O'Hagan*, results in the loss of potentially more efficient and effective state solutions.[208] Allowing the states to craft rules in this area would give rise to competition, and "[s]ubstantial evidence supports the proposition that allowing contracting parties to choose the applicable law can increase efficiency."[209]

Moreover, as a matter of jurisprudence, conduct that was once regulated by the states now becomes a matter of federal law, even if state law is not directly preempted. If the federal standard is more exacting or provides a longer statute of limitations or greater damages, the state law may become obsolete. Carefully crafted state causes of action are eliminated in favor of a federal claim. A state statute of frauds that, for instance, might have prohibited claims based on oral options would be preempted by *Wharf*. While the promulgation of the Sarbanes-Oxley Act in 2002[210] was met with considerable scholarly comment because it

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207. United States v. Morrison, 529 U.S. 598 (2000); *see* Lynn A. Baker & Ernest A. Young, *Federalism and the Double Standard of Judicial Review*, 51 DUKE L.J. 75 (2001) (noting how the Court vigorously enforces individual rights but applies a different standard when considering states' rights under the Constitution).

208. *See generally* Ribstein, *supra* note 84, at 155-58 (discussing the court's ambiguity in interpreting the existence of federal insider trading).

209. *Id.* at 156.

210. In passing the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of 11, 15, 118, 28, and 29 U.S.C.), Congress adopted a wide-ranging approach to the perceived causes of the financial crises typified by Enron and WorldCom. To the extent that these crises reflected a weakness in the regulation of the accounting profession, for instance, Sarbanes-Oxley created an accounting oversight board. Sarbanes-Oxley Act, §101, 116 Stat. at 750-53. Similarly, perceived weaknesses in the independence of the company's auditors were addressed with new rules to limit non-audit services, to require audit partner rotation, etc. *Id.* §§ 201-204, 116 Stat. at 771-75. The law also addressed corporate governance directly in what might be characterized as two separate sets of initiatives. The first set consists of changes in aspects of corporate governance that were already "federalized." Examples include a new requirement that the company's chief executive officer and chief financial officer certify the company's periodic filings with the SEC. *Id.* § 302, 116 Stat. at 777-78. This

regulated aspects of corporate governance traditionally regulated under state law, the Court's preemption of state law has received relatively little comment, but is at least as important.

Finally, interpreting federal laws so as to displace state law inevitably results in the arrested development of state law. This was the case for insider trading when litigation under Rule 10b-5 effectively eliminated state claims.[211] With respect to insider trading, for instance, Professor Ribstein observed:

> [I]t is unclear whether state law can survive in the shadow of federal law, at least as long as investors can choose among state and federal remedies ex post. Investor-plaintiffs plainly have incentives to choose the most stringent remedy. This removes state lawmakers' incentives to compete actively or to innovate regarding remedies that optimize costs as well as benefits.[212]

From a jurisprudential perspective, this may be unfortunate as it spells the end to the common law tradition of developing law to meet changing conditions. Instead, the focus will shift to Congress and the federal courts to deal with an ever-changing legal landscape. All this will have taken place without the full and open debate that ought to accompany such a significant change in the law.

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requirement alters the rules of corporate governance, as the functions and responsibilities of corporate officers are typically matters of state law. However, the federal securities laws have always specified who signs documents to be filed with the SEC, so requiring officer certification to periodic reports did not reflect a significant change in the state-federal relationship.

The second set of initiatives, of greater importance here, are forays into what had been the province of the states. These include forfeiture of certain bonuses and profits and a bar on loans to officers and directors. 15 U.S.C.A. § 7243, §78(m)(k) (2005). Each of these provisions addressed abuses at Enron and other companies, where officers realized substantial bonuses on the basis of fraudulent financial statements and benefited from large loans from the company.

211. WANG & STEINBERG, *supra* note 87, § 16.2.

212. Ribstein, *supra* note 84, at 157.

OVERWORK AND OVERTIME

SHIRLEY LUNG*

INTRODUCTION

There is no clearly established public policy which requires employers to refrain from demanding that their adult employees work long hours. Nor is [there] any public policy directly served by an employee's refusal to work long hours.[1]

The unit is already short staffed on your shift. . . . You are told to work extra hours or one more shift. No one asks you if you have children in school or daycare, if it is a special day for you or a loved one. No one cares, or so it seems, whether working this mandatory overtime will hurt you or your family.[2]

They won't let us go unless we have everything finished. So we have to work overtime. . . . If we didn't finish the work even in 10 hours, we stay until 2 a.m. We have to finish the work. . . . If one goes, [they say] we'll all want to go, so they never let us go. If there's an emergency, they ask for proof. . . . If you don't want to s[t]ay, then they tell you tomorrow don't come in.[3]

If you make the choice to have a home life, you will be ranked and rated at the bottom. I was willing to work the endless hours, come in on weekends, travel to the ends of the earth. I had no hobbies, no outside interests. If I wasn't involved with the company, I wasn't anything.[4]

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1. Upton v. JWP Businessland, 682 N.E.2d 1357, 1359 (Mass. 1997).

2. *The Time Has Come to Deal with Mandatory Overtime*, CAN NEWSLETTER (Cal. Nurses Ass'n, Oakland, Cal.), 2001 (on file with author) (quoting Kay McVay, President, California Nurses Association).

3. REBEKAH LEVIN & ROBERT GINSBURG, CTR. FOR IMPACT RESEARCH, SWEATSHOPS IN CHICAGO: A SURVEY OF WORKING CONDITIONS IN LOW-INCOME AND IMMIGRANT COMMUNITIES 21 (2000), http://www.impactresearch.org/documents/sweatshop report.pdf (quoting a food packer worker).

4. JILL ANDRESKY FRASER, WHITE-COLLAR SWEATSHOP 158 (2001) (quoting an Intel

The overwhelming majority of workers in the United States have no right to protection from being forced by their employers to work excessive hours. Almost one in five workers is required to work paid or unpaid overtime once or more a week with little or no notice.[5] Nearly one in three workers regularly works more than forty hours a week while one in five workers clocks over fifty hours a week.[6] More than eighty percent of those who work over fifty hours prefer fewer hours.[7] Although annual work hours declined in all industrialized countries in the last century,[8] work hours are now escalating in the United States and a handful of other industrialized countries that, like the United States, are wracked by widening income inequality, stagnant or falling incomes, and deregulation.[9]

The proportion of American workers who work fifty hours or more per week is among the highest in the industrialized world.[10] In 2000, American workers topped the list for the number of average hours worked per year (1979), outpacing workers in nineteen other industrialized countries.[11] On average, Americans work 350 more hours per year than Europeans.[12] Further, working time has intensified for individuals across income, education, and occupation levels. As a result, American families are working more weeks per year and more hours per week

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worker).

5. JAMES T. BOND ET AL., FAMILIES & WORK INST., THE 1997 NATIONAL STUDY OF THE CHANGING WORKFORCE: EXECUTIVE SUMMARY 9 (1998), *available at* http://www.familiesandwork.org/summary/nscw.pdf [hereinafter CHANGING WORKFORCE].

6. LONNIE GOLDEN & HELENE JORGENSEN, ECON. POL. INST., TIME AFTER TIME: MANDATORY OVERTIME IN THE U.S. ECONOMY 1 (2002), http://www.epinet.org/content.cfm/briefingpapers_bp120.

7. Jerry A. Jacobs & Kathleen Gerson, *Who Are the Overworked Americans?*, 56 REV. SOC. ECON. 442, 454 (1998). Specifically, those working between fifty and sixty hours would like to work twelve hours less while those working more than sixty hours want to work twenty hours less. *Id.* A study surveying a representative sample of the nation's labor force concludes that sixty-three percent of all workers prefer to work fewer hours. CHANGING WORKFORCE, *supra* note 5, at 8.

8. Gerhard Bosch, *Working Time: Tendencies and Emerging Issues*, 138 INT'L LABOUR REV. 131, 135 (1999).

9. *Id.* at 135, 138. The United States, United Kingdom, and New Zealand are most notable in the trend toward increased work time. *Id.* at 135. See JULIET B. SCHOR, THE OVERWORKED AMERICAN: THE UNEXPECTED DECLINE OF LEISURE (1991) for an in-depth study of the rise in working hours for American workers. It was Schor's study that first ignited alarm about escalating work hours in the United States.

10. Jacobs & Gerson, *supra* note 7, at 449-50; MARC LINDER, THE AUTOCRATICALLY FLEXIBLE WORKPLACE: A HISTORY OF OVERTIME REGULATION IN THE UNITED STATES 7 (2002).

11. LAWRENCE MISHEL ET AL., ECONOMIC POLICY INST., THE STATE OF WORKING AMERICA 423 (Drmonk: M.E. Sharpe 2003); LINDER, *supra* note 10, at 7. Between 1979 and 2000, as most other industrialized countries brought down their average hours worked per year, the United States increased its average hours by thirty-two hours. MISHEL ET AL., *supra*, at 423.

12. Steven Greenhouse, *Running on Empty: So Much Work, So Little Time*, N.Y. TIMES, Sept. 5, 1999, § 4, at 1.

than ever.[13] This has put both married-couple and single-parent families in a "time crunch," with women bearing the brunt of these pressures because of their disproportionate responsibilities in the home.[14]

Overwork, compulsory overtime, and the lack of control that workers exercise over the boundary between work time and private time are among the most troublesome labor conditions that now assail workers in the United States.[15] In the late nineteenth century, industrial workers who toiled ten hours a day and six days a week in factories, mines, and mills joined an international working class that launched a militant shorter hours movement for the eight-hour day.[16] Today, the epidemic of long hours in the United States is borne by workers across the class divide, whether they stitch garments, drive trucks, clean offices, design software, provide nursing care, or represent clients in court.[17] Likewise, union membership does not guarantee protection from compulsory overtime.[18]

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13. MISHEL ET AL., *supra* note 11, at 112. The average family in the United States increased the number of weeks worked per year by nearly twelve weeks between 1969 and 2000; middle- and lower-middle income families added twenty weeks in the same time period, and lower-income families added more than ten weeks between 1979 and 2000. *Id.* at 98. The pattern for annual hours worked per year by families shows similarly large gains. *Id.* at 99. Middle-income families added 660 annual hours between 1979 and 2000, the equivalent of sixteen weeks of full-time work. *Id.* Annual work hours for low-income families grew by 15.9% in the same period. *Id.*; *see* COUNCIL OF ECON. ADVISERS, FAMILIES AND THE LABOR MARKET, 1969-1999: ANALYZING THE "TIME CRUNCH" 4-5 (1999), http://clinton4.nara.gov/media/pdf/famfinal.pdf [hereinafter TIME CRUNCH] ("All types of families—whether defined by the head's education level, spouse's education level, presence of young children, or race or ethnicity of the household head—have experienced substantial increases in hours of paid work from 1969 to 1996.").

14. *See* TIME CRUNCH, *supra* note 13, at 12-13 (noting that women's increased hours of paid work have reduced the time that parents spend with children and have placed a special "time crunch" on employed women, "[who] spend over one third less time on child care and household tasks than women without paid jobs, but still have 25 to 30 percent less free time"). The report found that the increased hours of paid work for families from 1969-1996 have resulted in parents having on average twenty-two fewer hours per week to spend with their children. *See id.* at 11-13; *see also* Deborah L. Rhode, *Balanced Lives*, 102 COLUM. L. REV. 834, 841-43 (2002) (describing women's unequal or "disproportionate obligations" in the home).

15. *See generally* TODD D. RAKOFF, A TIME FOR EVERY PURPOSE: LAW AND THE BALANCE OF LIFE (2002); Rhode, *supra* note 14; Vicki Schultz, *Life's Work*, 100 COLUM. L. REV. 1881 (2000); Michael L. Smith, Note, *Mandatory Overtime and Quality of Life in the 1990s*, 21 J. CORP. L. 599 (1996); CHANGING WORKFORCE, *supra* note 5; GOLDEN & JORGENSEN, *supra* note 6.

16. *See* SCHOR, *supra* note 9, at 72-74 (discussing workers' struggles to reduce working time in the late 1800s); Scott D. Miller, *Revitalizing the FLSA*, 19 HOFSTRA LAB. & EMP. L.J. 1, 7-14 (2001) (describing the shorter hours movement in the United States). "[F]rom 1890 onwards, a central demand of the labour movement all over the world was the call for an eight-hour working day . . . ." Bosch, *supra* note 8, at 131.

17. *See infra* Part I.C (discussing overtime and compulsory overtime across the class divide).

18. *See* Smith, *supra* note 15, at 607-12 (discussing how various collective bargaining agreements have addressed mandatory overtime). Smith reports that approximately thirty percent

Declining membership and some unions' simultaneous fight to negotiate higher compensation for overtime work has undermined the ability of organized labor to negotiate bans or curbs on employer demands for mandatory overtime hours.[19]

More than any other labor condition, the issues of compulsory overtime and overwork present a growing "convergence" between workers regardless of their occupation, income, education, race, gender, or citizenship.[20] Immigrants and other low-wage workers toil excessive hours in traditional sweatshops, such as garment factories and restaurants, and in numerous other industry sectors as well.[21] At the same time, exposés of "white-collar" and "electronic" sweatshops debunk the glamour of high-tech employment revealing large numbers of higher-paid skilled workers who work upwards of seventy to ninety hours a week under increasingly autocratic conditions.[22]

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of union contracts nationwide address overtime in some manner, and that a representative sampling of collective bargaining agreements from Iowa over the last two decades indicates that many agreements contained no provisions on mandatory overtime. *Id.* at 608. Smith concludes that "[a] given union's lack of bargaining power may result in just as unfavorable an agreement as employer-imposed mandates on at-will workers." *Id.* at 622.

19. *See* LINDER, *supra* note 10, at 11-13, 29-31 (explaining the contradictory position of organized labor on the issue of overtime as some unions and workers fight to preserve unlimited overtime as a way of boosting earnings while others fight against mandatory overtime and increased hours in the wake of layoffs); GOLDEN & JORGENSEN, *supra* note 6, at 9 (describing trends that weaken the ability of unions to negotiate terms on mandatory overtime).

20. *See infra* Part I.C (discussing the impact of overwork and overtime on workers in various occupations); Deborah C. Malamud, *Engineering the Middle Classes: Class Line-Drawing in New Deal Hours Legislation*, 96 MICH. L. REV. 2212, 2316-17 (1998) (arguing that because of bureaucratization of all forms of work, employers view all of their employees, including professionals, as subject to the clock). Malamud concludes there is a clear "trend of convergence in the work structure and working conditions of upper-level and ordinary workers" based on working hours, and the assumption that professional work is "noncommodified and nondivisible" must be reexamined. *Id.* at 2319; *see also* FRASER, *supra* note 4, at 20-24 (describing the long working hours of white collar workers in corporate and high-tech employment as reflective of "an industrial revolution for white-collar workers" that has resulted in "white-collar sweatshops"); Marion Crain, *The Transformation of the Professional Workforce*, 79 CHI.-KENT L. REV. 543, 564-78 (2004) (describing the commodification of medicine and law through loss of control over hours of work and pace of work as a major source of discontent among professionals); Andrew Ross, *Sweated Labor in Cyberspace*, NEW LAB. FORUM, Spring/Summer 1999, at 47 (likening conditions in the high-tech industry to those in the garment industry); Schultz, *supra* note 15, at 1919 (observing that most workers "are in danger of becoming 'women,' in the sense that they are experiencing the problems and dilemmas that women have traditionally faced with respect to paid work").

21. *See* Thomas Maier, *Death on the Job: Immigrants at Risk: Blood, Sweat, Tears: Chinese Sweatshop Workers Are Among Most Exploited*, NEWSDAY, July 26, 2001, at A6; Bob Port, *Toil and Tragedy*, DAILY NEWS (N.Y.), July 8, 2001, at 29.

22. *See also* WASH. ALLIANCE OF TECH. WORKERS, DISPARITIES WITHIN THE DIGITAL WORLD: REALITIES OF THE NEW ECONOMY 11-14 (no date), http://www.washtech.org/reports/

Although diverse groups of workers express increasing dissatisfaction with overwork and compulsory overtime, the Bush administration and Republican Congress have successfully commandeered reform of the Fair Labor Standards Act of 1938 ("FLSA"),[23] with a legislative agenda that will effectuate greater deregulation of overtime.[24] In response, the AFL-CIO has sought to preserve the ability of low- and middle-income families to augment stagnant wages through overtime.[25] Its central theme for mobilizing the public is that the right to overtime compensation must be kept intact.

However, there is an urgent need to expand the national discussion about reform of the FLSA beyond the protection of overtime compensation to tackle the debilitating phenomenon of compulsory overtime and overwork. The current regulatory regime grants employers the unfettered right and power to impose excessive hours of work on employees even when long hours imperil workers'

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fordreport/ford_ report.pdf [hereinafter WASHINGTON ALLIANCE] (documenting wage disparities within the information technology industry and arguing that the myth of high wages masks the prevalence of low-wage work in the industry). *See generally* FRASER, *supra* note 4 (documenting the forced long hours, and decreasing salaries and benefits that a variety of professional workers, including high-tech professionals, experience as a consequence of downsizing, layoffs, and workplace re-engineering).

23. Fair Labor Standards Act of 1938, 29 U.S.C. §§ 201-219 (2000).

24. The latest overtime regulations promulgated by the U.S. Department of Labor are expected to result in millions of workers being disqualified from the right to premium pay under the exemptions for professional, administrative, and executive employees. *See Final Rule on Overtime Pay: Hearing Before the Subcomm. on Labor, Health and Human Services, Education of the S. Comm. on Appropriations*, 108th Cong. (2004) (statement of Ross Eisenbrey, Vice President and Director of Policy, Economic Policy Institute) (summarizing the new definitions and tests for exempt employees that are expected to result in longer hours and less pay for millions of workers, such as chefs and cooks, nursery school teachers, working foremen, and working supervisors); *The Department of Labor's Overtime Regulations Effect on Small Business: Hearing Before the Subcomm. on Workforce, Empowerment, and Government Programs, H. Comm. on Small Business*, 108th Cong. (2004) (statement of Ross Eisenbrey, Vice President and Director of Policy, Economic Policy Institute) (arguing that the creation of new exemptions for certain occupations and the elimination of certain bright line tests will cause many to lose the right to overtime pay); *infra* notes 164-69 and accompanying text; *see also* LINDER, *supra* note 10, at 14-15 (criticizing Republican proposals to base overtime pay on a two-week eighty-hour work period rather than the current forty-hour work week); David J. Walsh, *The FLSA Comp Time Controversy: Fostering Flexibility or Diminishing Worker Rights?*, 20 BERKELEY J. EMP. & LAB. L. 74, 126-27 (1999) (arguing against the adoption of legislative proposals that would permit employers to substitute compensatory time off for overtime pay). Walsh maintains that "comp time" measures would undermine the overtime requirements of FLSA, invite heavier use of overtime, and result in lower earnings and longer hours. *Id.* at 127.

25. *See* Statement by AFL-CIO President John J. Sweeney on EPI Analysis of Bush Administration Proposed Cuts to Overtime Pay (June 26, 2003) (on file with author), *available at* http://aflcio.org/mediacenter/PRSptm/pr06262003.cfm [hereinafter Sweeney Statement].

lives, health, and safety.[26] By all accounts, the premium pay requirement for overtime has failed as a financial deterrent to the growth of jobs with very long hours.[27] Workers caught in a system of compulsory overtime complain of overexertion, rising rates of occupational illnesses, crippling workplace accidents, and ruined health.[28] Further, the power of employers to require overtime at the expense of workers' private time is undermining the ability of workers to spend time with their families and to engage in the vital social, community, and civic activities that help create an engaged citizenry.[29] Some scholars call for immediate reform of the FLSA to embrace a fundamental goal that policymakers never adopted at the time of its enactment—namely, ensuring sufficient time for workers to fulfill other important social responsibilities besides work.[30]

This Article will assess the need for workers to claim control over their working hours and will explore the right to refuse overtime as the fundamental first step toward that goal. Part I examines the prevalence of compulsory overtime across the class divide in the context of globalization and a regulatory regime that grants employers the right to compel excessive hours. Part II considers the prospect of unifying workers across classes and occupations over the issue of control of time. Part III examines the efforts of workers who are challenging compulsory overtime and explores whether a statutory right to refuse overtime could meaningfully empower workers to resist employers' demands for long hours. This Article concludes that breaking down class divisions to organize

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26. *See infra* Part I.A (discussing gaps in the FLSA for protecting workers from forced overtime).

27. *See* LINDER, *supra* note 10, at 46; RAKOFF, *supra* note 15, at 77; Juliet B. Schor, *Worktime in Contemporary Context: Amending the Fair Labor Standards Act*, 70 CHI.-KENT L. REV. 157, 168 (1994); Smith, *supra* note 15, at 600.

28. National Mobilization Against SweatShops, It's About TIME!—Campaign for Workers' Health, http://www.nmass.org/nmass/wcomp/workerscomp.html (last visited Oct. 23, 2005) [hereinafter It's About TIME!]; John Schwartz, *Always on the Job, Employees Pay with Health*, N.Y. TIMES, Sept. 5, 2004, § 1, at 1; *see* CLAIRE C. CARUSO ET AL., U.S. DEP'T OF HEALTH & HUMAN SERVS., OVERTIME AND EXTENDED WORK SHIFTS: RECENT FINDINGS ON ILLNESSES, INJURIES, AND HEALTH BEHAVIORS 27 (2004), http://www.cdc.gov/niosh/docs/2004-143/pdfs/2004-143.pdf (study finding that overtime is associated with poorer health, increased injury rates, greater incidences of illnesses, and increased mortality).

29. *See* RAKOFF, *supra* note 15, at 136-41 (arguing that under our current legal regime, the power of employers to demand overtime from workers usually trumps family and other outside responsibilities that workers have). Consequently, "[t]he presumptive rhythm is the rhythm of work, even when the work rhythm is the rhythm of overtime," *id.* at 139, and interferes with the multiple social roles that workers should be able to fulfill. *Id.* at 140. Rakoff cautions, "the demands of the workplace threaten to destroy the balance of life." *Id.* at 155; *see also* Rhode, *supra* note 14, at 834-35, 846 (positing the need to re-envision policies and cultural values, and to restructure workplaces, to enable workers to achieve "a fuller integration of employment, family, and civic commitments"); Schultz, *supra* note 15, at 1928-39 (suggesting reforms to make paid-work a more satisfying and saner experience for all working people across the spectrum).

30. *See* RAKOFF, *supra* note 15, at 68; Malamud, *supra* note 20, at 2222, 2319-20.

workers to win an absolute right to refuse long hours would be a critical milestone in the larger project of helping workers gain control over the boundaries between work time and non-work time.

I. COMPULSORY OVERTIME ACROSS THE CLASS DIVIDE

A. The Right of Employers to Compel Overtime

Undeniably, a legal system that grants employers the right to compel unlimited overtime underpins the ability of employers to extract more from workers. The historic social movement for the eight-hour day sought to bring the issue of working hours within the sphere of worker control.[31] The movement was predicated on the grand vision of safeguarding workers' non-work time from the demands of employers to ensure that workers would have sufficient leisure time to dedicate to self-development and political participation as citizens.[32] This radical struggle was short-circuited in favor of the enactment of the FLSA,[33] a comparatively modest piece of legislation with hours provisions intended mainly as a work-spreading measure to alleviate unemployment.[34] Prior to the FLSA, an array of state and federal laws imposed ceilings on the maximum work hours for

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31. *See* Malamud, *supra* note 20, at 2223.

32. *See* LINDER, *supra* note 10, at 24-31 (contrasting the collectivist goals of the shorter hours movement with the individualistic "family values" approach of contemporary labor unions); Malamud, *supra* note 20, at 2223 (listing major goals of the shorter hours movement as protecting workers' health and safety, decreasing unemployment, increasing workers' leisure time for social and political development, and establishing worker control over the industrial process through control of work hours); Miller, *supra* note 16, at 7, 10-14 (providing an overview of the shorter hours movement in the United States).

33. Fair Labor Standards Act of 1938, 29 U.S.C. §§ 201-219 (2000).

34. *See* Malamud, *supra* note 20, at 2223 (stating that work-spreading was the principal goal of the New Deal's policy on hours, and positing that pre-New Deal and New Deal legislation never embraced the shorter hours movement's goals of increasing leisure time and worker control over time). Malamud argues that FLSA should be unmoored from its work-spreading goal to embrace the goals of increasing leisure time for workers so that workers can "function simultaneously as workers, parents, and citizens." *Id.* at 2319; *see also* LINDER, *supra* note 10, at 60 (explaining that according to one interpretation, the defeat of Senator Hugo Black's thirty-hour work week bill in favor of the FLSA's overtime provisions signaled that "the forces advocating increased production and employment [had] prevailed over the continuing campaign for shorter hours"); RAKOFF, *supra* note 15, at 68 (suggesting that the rationale for the FLSA "must be reconstructed" to establish a legal limit on working time to ensure time is available for other important social roles and activities). Although Rakoff seems to be in agreement with Malamud's proposition that the FLSA's original goals did not include setting a limit on work time to enable workers to achieve a proper balance of time for work and non-work activities, he questions whether the FLSA provisions on overtime were intended principally to alleviate unemployment. He argues instead that the goals of the FLSA, as shown by Congress's legal justifications for the Act's limits on contractual freedom, were to curb oppressive working conditions and unfair competition. *Id.* at 65-66.

various groups of workers.[35] The FLSA represented a paradigm shift by halting federal progress toward reducing the ceiling on maximum work hours in favor of permitting employers to require unlimited overtime hours if they were willing to pay for it.[36]

The FLSA regulates merely two aspects of working hours—it establishes the forty-hour work week as the norm, and it requires premium pay of one and one-half the rate of regular pay for any hour worked in excess of forty hours a week.[37] The Act excludes various groups of workers from the overtime premium pay requirements, most notably those who are "employed in a bona fide executive, administrative, or professional capacity."[38] Strikingly, the Act fails to provide workers with any affirmative protection from being compelled to work excessive hours against their will. The Act neither limits the length of the workday or week through caps, nor regulates the number of overtime hours that a worker can be forced to work.[39] The Act contains no provisions that guarantee workers a minimum number of rest days.[40] In addition, the Act does not carve out a role, even a small one, for workers in making overtime determinations. Decisions about whether overtime work is needed, the amount of overtime, and the scheduling of overtime are relegated to the managerial prerogative of the employer.[41]

The FLSA also contains no safeguards for workers against retaliation for refusing to work overtime, no matter how excessive or unreasonable the

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35. *See* LINDER, *supra* note 10, at 60-61 (providing examples of federal statutes that place a ceiling on maximum work hours for certain federal employees), and 62-68 (describing state laws that set caps on work hours for women and workers in specific industries); Miller, *supra* note 16, at 15-18 (providing an overview of federal regulation of maximum work hours in the pre-New Deal era, including the codes promulgated by the National Industrial Recovery Administration).

36. *See* LINDER, *supra* note 10, at 250-51 (explaining that, from its inception, the FLSA was an overtime law rather than a statutory limit on work hours despite broad popular support for the latter); Malamud, *supra* note 20, at 2288 (noting that the various FLSA bills represented a "move from a true maximum hours bill to a bill that permitted unlimited overtime hours" as long as a premium was paid for it); Miller, *supra* note 16, at 14 (arguing that "[t]he FLSA stopped federal progress towards lowering the ceiling on maximum hours, replacing hours limits with financial disincentives such as minimum wage and overtime pay"); Schor, *supra* note 27, at 164 (stating that the FLSA was not a shorter hours bill and that it has contributed to longer hours for American workers).

37. 29 U.S.C. § 207(a)(1) (2000).

38. *Id.* § 213(a)(1).

39. LINDER, *supra* note 10, at 6 (noting that the amount of overtime hours worked could be limited based on the day, week, month, or year).

40. See *id.* for a description of the possible components of a work hours policy.

41. *See* LINDER, *supra* note 10, at 6 (stating that the legal regime in the United States for regulating work time is "distinctively underdeveloped," consisting solely of the forty-hour work week as the aspirational norm and the requirement of premium pay for overtime work); RAKOFF, *supra* note 15, at 130 (explaining that in an at-will employment system, "the law at the boundary between work time and family time is simply that the employer's rules control the situation").

employer's demand. Workers have no recourse under the FLSA if they are fired, demoted, reassigned, or otherwise punished for declining overtime. Workers also have little chance of obtaining relief through wrongful discharge claims because courts narrowly construe the exceptions to the at-will employment doctrine.[42] Currently, there is no recognized right to refuse overtime under employment law.[43] Relief is most likely to come, if at all, from either an unemployment insurance claim,[44] which provides income support but not reinstatement, or a collective bargaining agreement, if the worker is covered by one.[45]

B. The Structural Context of Overwork and Overtime

With the steep rise in annual work hours for individuals and families, more than half of American workers report feeling overworked, overwhelmed by the amount of work they have to do, and/or lacking in time to reflect upon the work they are doing.[46] Overwork is attributable to several trends. First, the climb in annual family work hours since 1979 has coincided with an era of stagnant and falling wages.[47] Annual family work hours have swelled primarily because unprecedented numbers of women have entered the full-time workforce, and those who were already in the workforce have taken on increased hours of work to boost family incomes.[48] Without the increased work hours of women, lower- and middle-income families would have seen their incomes fall or at best remain stagnant.[49] African American and Latino families, whose average hours of work grew faster than white families throughout the 1980s and 1990s, would have been especially hard hit.[50]

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42. *See* RAKOFF, *supra* note 15, at 136-37, 144. The main exceptions to the at-will doctrine are the implied contract exception (limiting discharges when an implied promise of continued employment exists); the public policy exception (typically protecting workers who are terminated for refusing to commit an unlawful act, exercising a statutory right, or performing a public duty); and the implied covenant of good faith and fair dealing exception (balancing an employer's right to discharge against a worker's interest in his/her employment and the public's interest in striking a balance between these competing interests). Smith, *supra* note 15, at 603-06.

43. *See* RAKOFF, *supra* note 15, at 144.

44. *See id.* at 139-40; Smith, *supra* note 15, at 617. Both authors agree that workers receive more favorable treatment in unemployment insurance cases than in wrongful discharge cases on the issue of right to refuse mandatory overtime.

45. *See* RAKOFF, *supra* note 15, at 137-39, 142-44 (arguing that when arbitrators interpret collective bargaining agreements on the issue of mandatory overtime, they balance the reasonableness of the employer's demands against that of the worker's refusal to work overtime, and often the balance falls in favor of the employer).

46. ELLEN GALINSKY ET AL., FAMILIES & WORK INST., FEELING OVERWORKED: WHEN WORK BECOMES TOO MUCH 2 (2001); Jacobs & Gerson, *supra* note 7, at 450-51, 453.

47. MISHEL ET AL., *supra* note 11, at 6, 97.

48. *Id.* at 5, 111-12; Greenhouse, *supra* note 12; TIME CRUNCH, *supra* note 13, at 7-9.

49. MISHEL ET AL., *supra* note 11, at 104.

50. *Id.* at 101.

To a lesser degree, but of growing importance, workers are receiving less paid time off from work. Corporate restructuring has resulted in dwindling benefit packages that provide fewer paid vacation, holiday, and sick days.[51] Workers today are less likely to receive paid time off than they were thirty years ago.[52] In addition, many workers must forfeit their allotted vacation time because their employers pile too many job responsibilities and demands on them.[53]

Most significant, increased weekly overtime plays a distinctly corrosive role in the phenomenon of overwork.[54] Workers are not only working more weeks per year, but also longer days and work weeks. Almost one-third of workers work more than forty hours per week, and one-fifth work more than fifty hours per week.[55] In "agriculture, mining, manufacturing, transportation, communication, and some professional services, more than 25% of all employees reported that they [regularly] work at more than forty hours per week . . . , and often considerably more."[56] Those who work overtime in these industries clock, on average, almost twelve hours a week over the standard forty hours each week,[57] which is equivalent to nearly six-and-a-half eight-hour days per week.[58]

There has been a long-term upward trend in overtime hours[59] that shows no sign of reversing.[60] Hourly manufacturing workers now work twenty-five percent more overtime than they did ten years ago.[61] Average weekly overtime in

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51. SCHOR, *supra* note 9, at 32-33. Schor estimates that during the 1980s workers received three and a half fewer days each year of paid leave and absences. *Id.* at 32.

52. MISHEL ET AL., *supra* note 11, at 243.

53. GALINSKY ET AL., *supra* note 46, at 8; John Buell, *Vacations, Shopping Sprees, and Work Life*, 62 HUMANIST 40 (2002); Schwartz, *supra* note 28.

54. LINDER, *supra* note 10, at 33 (noting a lawsuit brought by a group of firefighters challenging the "coercive character and corrosive impact" of forced overtime as a violation of the constitutional ban on involuntary servitude).

55. GOLDEN & JORGENSEN, *supra* note 6, at 1. Over twenty-five million Americans work more than forty-nine hours each week, and some work considerably more than that. FRASER, *supra* note 4, at 20. Approximately fifteen million people, comprising twelve percent of the labor force, report working forty-nine to fifty-nine hours each week, and another eleven million, or 8.5%, report working sixty hours or more each week. *Id.* at 20-21.

56. GOLDEN & JORGENSEN, *supra* note 6, at 5; MISHEL ET AL., *supra* note 11, at 239.

57. GOLDEN & JORGENSEN, *supra* note 6, at 5; MISHEL ET AL., *supra* note 11, at 239.

58. MISHEL ET AL., *supra* note 11, at 239.

59. GOLDEN & JORGENSEN, *supra* note 6, at 5; Ron L. Hetrick, *Analyzing the Recent Upward Surge in Overtime Hours*, 123 MONTHLY LAB. REV. 30, 30-31, 33 (2000).

60. Barry Bluestone & Stephen Rose, *The Macroeconomics of Work Time*, 56 REV. SOC. ECON. 425, 429-30, 432-33 (1998).

61. GOLDEN & JORGENSEN, *supra* note 6, at 1. In particular, the period between March 1991 and January 1998 witnessed striking growth in overtime for most manufacturing industries, with the largest gains occurring in the motor vehicle, steel, and iron industries. Hetrick, *supra* note 59, at 30-31. Production workers in the manufacturing industry are the only workers whose hours are tracked by the government through the Bureau of Labor Statistics. *See* LINDER, *supra* note 10, at 32 n.50; GOLDEN & JORGENSEN, *supra* note 6, at 1.

manufacturing escalated in the 1990s from 3.3 hours to a high of 4.9 hours in 1997,[62] representing a forty-eight percent increase in overtime.[63] By the late 1990s weekly overtime had reached its "highest levels since the Bureau of Labor Statistics began collecting such data in 1956."[64]

The coercive and involuntary nature of excessive overtime aggravates its detrimental impact for many workers.[65] Studies find that workers who exercise some measure of control over their work feel less stressed and overworked.[66] Yet, with compulsory or involuntary overtime, decisions about whether overtime hours are needed, how much overtime, and when overtime is to be performed, lie outside the control of most workers.[67]

Compulsory, mandatory, or forced overtime is usually defined as hours worked in excess of forty hours per week "that the employer makes compulsory with the threat of job loss or the threat of other reprisals such as demotion or assignment to unattractive tasks or work shifts."[68] According to some commentators, the rise in mandatory overtime is commensurate with the rise in overtime hours.[69] In one of the few statistical studies on mandatory overtime, forty-five percent of workers surveyed reported that overtime was "mostly up to their employer."[70] In another study, one-third of workers who performed overtime reported being forced by their employer to do so.[71]

Just as corrosive as compulsory overtime is involuntary overtime. This has been described as "being 'forced to work voluntary overtime.'"[72] Although not actually threatened with dismissal or other adverse consequences, large groups of workers nonetheless feel "forced" to work overtime because they fear negative

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62. GOLDEN & JORGENSEN, *supra* note 6, at 5; Hetrick, *supra* note 59, at 33.

63. Hetrick, *supra* note 59, at 33.

64. LINDER, *supra* note 10, at 32; *see* GOLDEN & JORGENSEN, *supra* note 6, at 1.

65. LINDER, *supra* note 10, at 33; Smith, *supra* note 15, at 601; *see* GALINSKY ET AL., *supra* note 46, at 3 (citing statistics showing that workers who have less control over their work time and schedules feel more overworked); CARUSO ET AL., *supra* note 28, at 28 (finding that mandated or involuntary overtime placed workers at greater risk for sleep disorders, poor recovery, burnout, and family-related stress).

66. GALINSKY ET AL., *supra* note 46, at 7; Schwartz, *supra* note 28, at 22.

67. *See* Lonnie Golden, *Flexible Work Schedules: What are We Trading Off to Get Them?*, 124 MONTHLY LAB. REV. 50, 52 (2001) (observing that the daily and weekly scheduling of work are usually outside the control of workers and may often conflict with the time slots that workers need to fulfill other responsibilities and commitments).

68. GOLDEN & JORGENSEN, *supra* note 6, at 2.

69. *Id.* at 7; *see* Smith, *supra* note 15, at 601-02 (explaining that an important component of the "overtime boom" consists of mandatory overtime).

70. GOLDEN & JORGENSEN, *supra* note 6, at 5 (citing the 1977 Quality of Employment Survey of the University of Michigan).

71. *Id.* at 7 (citing a 1999 study by Cornell University's Institute for Workplace Studies).

72. Ann E. Rogers et al., *The Working Hours of Hospital Staff Nurses and Patient Safety*, DATA WATCH, July/Aug. 2004, at 209.

repercussions if they decline longer hours.[73] Although there are no studies measuring the prevalence of involuntary overtime, commentators indicate that it is widespread because job insecurity places intense pressure on workers to work whatever hours are necessary to handle the heavy workloads assigned to them.[74]

Some suggest that American workers have chosen to become a work-and-spend society in which long hours support an ever-expanding consumptive appetite.[75] The issue of choice, even for middle- and upper-middle class Americans, underplays the structural reasons that account for the pandemic nature of excessive hours of work.[76] In fact, nearly half of workers putting in long hours say they would prefer to work fewer hours.[77]

Increased work occurs in the context of global economic processes in which employers and government embrace longer hours and forced overtime as a policy choice.[78] The reorganization of work through corporate restructuring, which accelerated in the 1990s, has created a workforce of insecure workers who are either overworked, underworked, or unemployed.[79] Under the banner of

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73. *See* Schwartz, *supra* note 28, at 22 (attributing increased working hours to workplaces ruled by "the work ethic of fear"); GOLDEN & JORGENSEN, *supra* note 6, at 7-8 (noting that nearly one in five workers reported working more overtime than they prefer). As an example, sixty percent of nurses surveyed in one study "reported being 'forced to work voluntary overtime'" even though they were not actually threatened with termination or disciplinary proceedings. Rogers et al., *supra* note 72, at 209. Nurses stated that there would be repercussions for refusing extra hours or that, although overtime was voluntary, they felt as though it was required. *Id.*

74. FRASER, *supra* note 4, at 24. Fraser describes the pressure on workers by explaining, "[i]f they want to hold onto their paychecks and benefit packages, if they want to keep rising within the corporate hierarchy, if they still care about their careers, they will put in whatever hours are necessary to handle their workloads." *Id.*

75. *See* Buell, *supra* note 53 (noting the role of new consumption and materialism in contributing to long hours).

76. *See* Jacobs & Gerson, *supra* note 7, at 455 (suggesting that employers structure employment options and organize work schedules for reasons other than the preferences of their workers); Schor, *supra* note 27, at 162 (arguing the need for regulatory and legislative reform to address "deep structural barriers to shorter hours").

77. Schultz, *supra* note 15, at 1957; Jacobs & Gerson, *supra* note 7, at 454.

78. *See* LINDER, *supra* note 10, at 5 (explaining that employers and economists view longer hours as the engine that fuels economic growth); MISHEL ET AL., *supra* note 11, at 424 (noting that European nations, in contrast to the United States, have made an explicit policy choice to take their productivity gains in the form of shorter hours). Further, Mishel concludes that the higher standard of living in the United States as compared to other Organization for Economic Cooperation and Development (OECD) countries results not from greater efficiency but from longer hours. *Id.* at 424-29; *see also* Jacobs & Gerson, *supra* note 7, at 449-50 (stating that international comparisons between the United States and other industrialized countries suggest that long working hours "are neither inevitable nor inherent in post-industrial economic development").

79. *See generally* PETER CAPPELLI, THE NEW DEAL AT WORK: MANAGING THE MARKET-DRIVEN WORKFORCE (1999) (detailing the impact of restructuring and downsizing on creating massive job insecurity among full-time, contingent, and unemployed workers throughout the

"increasing global competitiveness" and "enhancing productivity," businesses have instituted systems of "lean" production to pare down.[80] This has been achieved through downsizing, massive layoffs, reliance on overtime instead of hiring new workers, the substitution of contingent workers for full-time workers, and the subcontracting of work.[81] Employers promote "flexible capitalism" as a means of strengthening their capacity to meet new product and consumer demands, and to adjust to rapidly changing business conditions.[82] Moreover, lean production is a permanent mainstay of the global economy, and not a short-term strategy for economic downturns.[83]

For workers, "flexible capitalism" and "global competitiveness" are euphemisms for being squeezed to work more for less pay. According to noted experts, flexible capitalism is "committed above all else to the idea of reducing fixed labor costs in the name of facilitating newness and change."[84] The creation of an insecure workforce, composed of several tiers of workers in competition with one another, is a fundamental corporate strategy for slashing labor costs.[85] Downsizing, layoffs, and outsourcing leave remaining full-time workers with increased workloads and harder and longer hours.[86] At the same time, companies increasingly resort to hiring part-timers, temporary workers, and independent contractors, many of whom work fewer hours than they desire.[87] Afraid of

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economy).

80. *See* KIM MOODY & SIMONE SAGOVAC, TIME OUT! THE CASE FOR A SHORTER WORK WEEK 7-8 (1995) (describing the transition to contingent work and subcontracting as examples of lean production); *see also* Schultz, *supra* note 15, at 1920-27 (detailing the workplace structures that constitute the new economic order).

81. *See* MOODY & SAGOVAC, *supra* note 80, at 7-8; Schultz, *supra* note 15, at 1920.

82. Schultz, *supra* note 15, at 1920.

83. *See* FRASER, *supra* note 4, at 138 (noting that more job cuts occurred in 1998, a strong growth year for the United States economy, than at any previous point in the 1990s); Louis Uchitelle, *Layoff Rate 8.7% Highest Since 80's*, N.Y. TIMES, Aug. 2, 2004, at C2.

84. Schultz, *supra* note 15, at 1921-22 (referring to the views of economists Bennett Harrison and Richard Sennett).

85. MOODY & SAGOVAC, *supra* note 80, at 10, 12; *see* Miller, *supra* note 16, at 95-96, 102-05 (describing the impact of worker insecurity as employers "churn" the workplace through layoffs); *see also* FRASER, *supra* note 4, at 44 (citing one economist who explains that, in a labor market with many unemployed and underemployed workers, fear is an effective tool for getting workers to perform for less); WASHINGTON ALLIANCE, *supra* note 22, at 20-21 (describing the treatment of contract workers within information technology companies as second-class citizens, and the impact of enforced social distinctions between permanent staff and contract workers).

86. *See* FRASER, *supra* note 4, at 38-45 (describing how many employers are simultaneously demanding more work from employees and cutting back on salaries and benefits). Fraser states that companies look for new ways to pare down on staffing "while pushing others to work at paces that once might have seemed unfair or unsustainable." *Id.* at 41.

87. This is particularly true of those workers who become temporary workers or part-timers because they are unable to find full-time work. *See* FRASER, *supra* note 4, at 140-41 (discussing the growth of contingent work); Jean McAllister, *Sisyphus at Work in the Warehouse: Temporary*

becoming the casualties in the next round of layoffs, outsourcing, or replacement of full-time jobs with temporary jobs, workers submit to onerous workloads and longer hours at reduced wages.[88]

Longer hours and forced overtime are critical employer strategies for lowering labor costs.[89] Employers who compel workers to work overtime avoid the costs associated with keeping a larger full-time staff or hiring new workers—among them, health insurance, paid vacation and sick leave, workers' compensation, and unemployment insurance.[90] The past two economic recoveries show that businesses deliberately rely on forced overtime as a substitute for hiring new full-time workers.[91] Between March 1991 and January 1998, "if employers had hired new workers instead of increasing overtime, nearly twice as many production workers would have been hired."[92] This would have translated into 571,000 full-time jobs.[93]

Wal-Mart, the nation's largest employer,[94] pushes reliance on overtime to a new frontier. The global giant, which has gained notoriety for establishing the model for post-industrial low-wage jobs,[95] deliberately and permanently understaffs its stores as a formula for ensuring that growth in labor costs lags behind store sales.[96] Inadequate staffing means that more work is piled on each

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Employment in Greenville, South Carolina, *in* CONTINGENT WORK: AMERICAN EMPLOYMENT RELATIONS IN TRANSITION 221, 230-31 (Kathleen Barker & Kathleen Christensen eds., 1998) (describing the insecurity and uncertainty of temporary work).

88. FRASER, *supra* note 4, at 42. One economist notes that during the 1980s and 1990s, many profitable companies cut the wages of their existing workforces by twenty to forty percent, and although workers complained, they did not quit. *Id.* at 44; *see* Doug Henwood et al., *Toward a Progressive View on Outsourcing*, NATION, Mar. 22, 2004, at 22, 26 (stating that "[a]lmost every employed person you talk to has [a survivor's tale of] taking on the responsibilities of employees who leave voluntarily or are laid off," and that this amounts to "working harder and longer for no increase in pay").

89. *See* MOODY & SAGOVAC, *supra* note 80, at 12-14 (explaining the economics of how overtime at time-and-a-half produces more value-added per hour than a new worker does at straight time); *see also* Ritu Bhatnaga, Dukes v. Wal-Mart *as a Catalyst for Social Activism*, 19 BERKELEY WOMEN'S L.J. 246, 250-51 (2004) (discussing forced unpaid overtime as a part of Wal-Mart's "highly systematized cost-cutting strategy that effectively suppresses wages and eliminates competition").

90. *See* Smith, *supra* note 15, at 600; Tina Kelley, *Earning It: When Overtime Doesn't Feel So Fine*, N.Y. TIMES, May 31, 1998, § 3, at 10.

91. Hetrick, *supra* note 59, at 32-33.

92. *Id.* at 32.

93. *Id.*

94. LABOR RESEARCH ASS'N, LOW-WAGE NATION 1 (2004), http://www.laborresearch.org/story2.php/358.

95. *See id.* (explaining the role of Wal-Mart in "defining the new industrial landscape" of low-wage service work in the United States).

96. *See* Simon Head, *Inside the Leviathan*, THE NEW YORK REVIEW OF BOOKS, Dec. 16, 2004, at 4-5 (detailing the squeeze on labor through the systematic and permanent understaffing

worker and store managers are left to squeeze extra hours, often without pay, from workers.[97] In this way, the cost of labor per unit of output plunges while profit margins climb.[98]

Further, as part of restructuring, some companies continue to hire robustly during and after layoff periods,[99] and overtime and longer hours figure importantly in recruitment. Young and less experienced workers are hired to replace older workers because they can be paid lower wages and hired at less costly benefit levels.[100] They are also desirable because employers can easily demand "large amounts of unpaid overtime" from them.[101] Employers perceive young workers as "unfettered" by family responsibilities, and thus more readily compliant with demands for long hours.

C. Overtime Across the Class Divide

Although "not all overtime is created equal,"[102] the phenomenon of compulsory overtime is color-blind and class-blind. In the last decade, the issue of mandatory overtime has spawned heated strikes by groups as diverse as nurses, autoworkers, security guards, and communication workers.[103] Long hours also rank as a main reason fueling an infant technology workers' union movement.[104] Class action lawsuits brought by managers and other white-collar workers challenging forced unpaid overtime have tripled since 1997.[105] Professionals such as lawyers,[106] nurses,[107] and doctors[108] form part of the growing chorus demanding

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of Wal-Mart stores). Wal-Mart provides its store managers with a preferred budget that would allow for adequate staffing but imposes on managers an actual budget that forces understaffing. *Id.* at 5.

97. *Id.* at 4-5.

98. *Id.* at 4.

99. FRASER, *supra* note 4, at 41.

100. *Id.* at 41, 139.

101. *Id.* at 139; *see* Laura Vanderkam, *Cities Covet Young Urban Single Professionals*, USA TODAY, Dec. 17, 2003, at 25A; Laura Vanderkam, *White-Collar Sweatshops Batter Young Workers*, USA TODAY, Nov. 26, 2002, at 13A.

102. LINDER, *supra* note 10, at 33 (referring to differences in job conditions between white-collar jobs and factory work).

103. *See infra* note 170.

104. *See* Aliza Earnshaw, *Portland Techies Look for Union Label*, THE BUS. J. OF PORTLAND, Oct. 27, 2003, at 2; Elizabeth Millard, *Time for a High-Tech Union?*, E-COMMERCE TIMES, Feb. 11, 2004, http://www.ecommercetimes.com/story/32823.html.

105. Laurence Viele, *Overtime Lawsuits by White-Collar Workers Surge*, HOUS. CHRON., May 27, 2004, at 1.

106. *See infra* pp. 71-72.

107. *See infra* p. 71.

108. *See* Crain, *supra* note 20, 580-87; *see also* Petition to the Occupational Safety and Health Admin. Requesting that Limits be Placed on Hours Worked by Medical Residents (Apr. 30, 2001), http://www.citizen.org/publications/release.cfm?ID=6771&secID=1164&catID=126.

curbs on excessive hours of work. More than any other labor issue, forced overtime and the lack of control that workers exercise over the boundaries between work and private time can be used to unify workers who might not seem to have much in common.

Sweatshops have been most popularly associated with immigrant workers toiling excessive hours in factories. In contrast to white-collar workers, blue-collar workers were historically viewed as subject to working on the clock, and thus most in need of protection through hours regulation.[109] Garment, restaurant, janitorial, and domestic workers, many of whom are female and immigrant workers, are frequently forced to work eighty to ninety hours per week;[110] forty hours is considered part-time for most of these workers.[111] Adding to the stress of long hours are oppressive practices—such as surveillance, intimidation, harassment, and control of movement—that are aimed at maximizing each worker's output per unit of time.[112] Sometimes workers are not permitted to take breaks, go to the bathroom, or even get a drink of water without suffering negative repercussions.[113]

Quite simply, many immigrant workers are faced with the stark choice of complying with required overtime, increased workloads, and frenetic work paces, or being fired.[114] Workers are pressured to compete with one another for longer hours to keep their jobs and avoid being replaced by workers who are more compliant with employer demands.[115] Undocumented immigrant workers are particularly susceptible to demands for excessive hours.[116] The threat of

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109. *See* Malamud, *supra* note 20, at 2263-64, 2294 (referring to the differential treatment of various groups of workers under New Deal legislation and its antecedents).

110. *See* It's About TIME!, *supra* note 28 (citing statistics about working hours for immigrant and other workers); Shirley Lung, *Exploiting the Joint Employer Doctrine: Providing a Break for Sweatshop Garment Workers*, 34 LOY. U. CHI. L.J. 291, 297 (describing long work hours in the garment industry); LEVIN & GINSBURG, *supra* note 3, at 21-22 (describing forced overtime and excessive hours of work without breaks by low income and immigrant workers in various industries).

111. It's About TIME!, *supra* note 28.

112. *See* Lung, *supra* note 110, at 291-92, 297; LEVIN & GINSBURG, *supra* note 3, at 22.

113. *See* LEVIN & GINSBURG, *supra* note 3, at 21-22; David Bacon, *No Rest for the Weary*, TRUTHOUT/PERSPECTIVE, Feb. 25, 2005 (originally published on www.truthout.org) (on file with author).

114. *See* LEVIN & GINSBURG, *supra* note 3, at 34-35.

115. *See* Lung, *supra* note 110, at 297, 358 n.47.

116. *See* CHIRAG MEHTA ET AL., U. OF ILL. AT CHI., CTR. FOR URBAN ECON. DEV., CHICAGO'S UNDOCUMENTED IMMIGRANTS: AN ANALYSIS OF WAGES, WORKING CONDITIONS, AND ECONOMIC CONTRIBUTIONS 29 (2002) (discussing data that suggests a strong correlation between undocumented status and wage and hour violations); Michael J. Wishnie, *The Border Crossed Us: Current Issues in Immigrant Labor*, 28 N.Y.U. REV. L. & SOC. CHANGE 389, 389-90 (2004) (documenting retaliation by sweatshop bosses against immigrant workers through immigration enforcement); Michael J. Wishnie, *Emerging Issues for Undocumented Workers*, 6 U. PA. J. LAB. & EMP. L. 497, 505-08 (2004) (discussing the unavailability of backpay remedies for undocumented

deportation, along with the criminalization of their work status, creates a climate of vulnerability that unscrupulous employers use to cheapen labor and extract more work.[117] At the same time, documented workers, too, are threatened with termination if they refuse poor working conditions—their employers tell them that they can be easily replaced by undocumented workers.[118]

Publicity surrounding Wal-Mart's wage-slashing strategies reveals that forced overtime and working off the clock are as pervasive for low-wage service workers in retail as they are for immigrant factory workers.[119] In lawsuits against Wal-Mart and other large retailers, workers complain of forced or involuntary unpaid overtime as a systematic practice.[120] Workers explain that they are forced or pressured by managers to clock out after forty hours and to continue working to keep up with the large amount of work that is piled on them because of permanent understaffing.[121] Wal-Mart managers are sometimes instructed to erase hours from workers' time records to help the company avoid overtime costs.[122] Managers at other retailers have their own tactics and euphemisms for squeezing longer hours from workers, such as pressuring "ambitious" hourly workers to "[pay] their dues" or "wheedling" workers to put in "volunteer days" or "free labor days" as part of a "development plan."[123] Workers succumb to unpaid overtime because of job insecurity, especially in small communities where there is a scarcity of good jobs and a high premium on being able to hold onto a job.[124] Job insecurity, the desire to curry favor with managers, and the wish to keep up with one's co-workers, have led some retail workers to compete for off-the-clock work.[125]

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workers who are illegally fired because of their workplace organizing activities).

117. *See* Break the Chains Alliance, Employer Sanctions Concept Paper (Mar. 7, 2005) (discussing the impact of the employer sanctions provisions of the Immigration Reform and Control Act of 1986 on documented and undocumented workers) (unpublished paper, on file with author).

118. Interview with Michael Lalan, Organizer, Nat'l Mobilization Against SweatShops, in Brooklyn, N.Y. (Mar. 4, 2005).

119. *See* Bhatnagna, *supra* note 89, at 246-56; Steven Greenhouse, *U.S. Jury Cites Unpaid Work at Wal-Mart*, N.Y. TIMES, Dec. 20, 2002, at A26.

120. *See* Head, *supra* note 96, at 4-5; Andrew Murr, *Pay? How About a Pizza?*, NEWSWEEK, Apr. 20, 1998, at 42.

121. Head, *supra* note 96, at 5; Greenhouse, *supra* note 119; *see* Murr, *supra* note 120.

122. Greenhouse, *supra* note 119.

123. *See* Murr, *supra* note 120.

124. *See* Greenhouse, *supra* note 119 (referring to testimony by a former Wal-Mart manager stating that he feared losing his job if he took more than forty hours to complete his work and put in for overtime pay). This manager explained, "'[b]ecause it's such a small community, jobs aren't that good there. . . . You held on to your job. I feared losing my job. I feared getting fired.'" *Id.* A lawyer representing Wal-Mart workers in one class action suit against the giant retailer stated that witnesses at trial testified that the culture at Wal-Mart was such that "if you want to work there a long time, you have to work off the clock." *Id.*

125. One group of Wal-Mart workers formed "the Over-40 Club," in which members worked more than forty-hour work weeks and then asked their managers to subtract hours from their time

The relentless drive by businesses to push down the cost of labor per unit of output has not left white-collar and higher-waged workers unscathed. Class status and privilege have not insulated professionals, executives, or administrators from excessive hours of work, forced overtime, or uncompensated overtime.[126] Some economists suggest that professionals and managers are among those most likely to work excessively long work weeks[127] and the longest hours.[128] In addition, new technologies contribute to a job spillover that further erodes the demarcation between work time and private time as workers spend more of their private time answering work-related voicemails and e-mails.[129] Mounting evidence indicates that white-collar workers today are as commodified as low-wage, unskilled workers, and as powerless to protect their private time from employer demands for excessive hours.[130]

Salaried managers and executives report that the long hours they work "make them feel more like production workers on an assembly line."[131] The social construction of the white-collar worker as an "ambitious" employee who "volunteers" to work unpaid overtime to "move up" the career ladder, in contrast to the low-paid worker who puts in long hours in a dead-end job, has been used to differentiate overtime based on class status.[132] The overtime hours worked by white-collar workers are not popularly perceived as exploitation. Yet increasingly, "profit-driven management techniques," bureaucratization, product standardization, and restructuring eliminate professional autonomy and control over hours of work and pace of work.[133] The workplaces of professionals can be

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cards. *Id.*

126. *See* FRASER, *supra* note 4, at 20-21 (noting that many of those working excessive hours are white-collar professionals); RAKOFF, *supra* note 15, at 79-80 (concluding that professionals may be in a worse position than non-professionals because there are no disincentives to stop employers from requiring professionals to work excessive hours); Greenhouse, *supra* note 12 (discussing that salaried workers such as software designers, lawyers, and factory managers are among those working long work weeks); Viele, *supra* note 105 (explaining that the number of lawsuits brought by white-collar workers challenging forced unpaid overtime are on the rise).

127. Philip L. Rones et al., *Trends in Hours of Work in the United States*, *in* WORKING TIME IN COMPARATIVE PERSPECTIVE 45, 56 (Ging Wong & Garnett Picot eds., 2001).

128. Mary Williams Walsh, *As Hot Economy Pushes Up Overtime, Fatigue Becomes a Labor Issue*, N.Y. TIMES, Sept. 17, 2000, § 1, at 32.

129. *See* FRASER, *supra* note 4, at 76-81.

130. *See* Malamud, *supra* note 20, at 2305-06 (referring to alternative images of overtime work based on occupation); Keith Cunningham, Note, *Father Time: Flexible Work Arrangements and the Law Firm's Failure of the Family*, 53 STAN. L. REV. 967, 983-84 (2001) (noting that long hours for lawyers are seen as a proxy for dedication and commitment to one's clients).

131. Walsh, *supra* note 128.

132. *See* Malamud, *supra* note 20, at 2305-06 (describing how one New Deal Wage and Hour administrator fought to overcome the social construction of all white-collar workers as upwardly mobile in arguing against the wholesale exemption of white-collar workers from hours regulation).

133. Crain, *supra* note 20, at 555-58, 560-61.

as autocratic as those of low-waged service or manufacturing workers.[134]

For example, it is widely documented that nurses are often forced against their will to work long overtime shifts,[135] including double shifts,[136] and as a result their overtime hours are notoriously excessive.[137] Reliance on mandatory overtime by hospitals emerged as a cost-cutting measure when restructuring and mergers in healthcare reform in the 1990s led hospitals to downsize their staff of registered nurses.[138] This restructuring resulted in severe and permanent understaffing, which hospitals covered by forcing nurses to work mandatory overtime and by using unlicensed personnel who were supervised by nurses.[139] Nurses are threatened with being fired, subjected to disciplinary proceedings, or losing their licenses under the charge of patient abandonment if they refuse to stay past their regular shift or come into work on their day off.[140]

Lawyers, too, face heightening pressure for longer hours due to restructuring and "corporatization."[141] Like hospitals, large law firms have adopted restructuring and profit maximizing strategies that emphasize efficiency and productivity.[142] Demands for greater productivity and longer hours come in the

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134. *See generally* FRASER, *supra* note 9.

135. *See* Kristin M. Mannino, Note, *The Nursing Shortage: Contributing Factors, Risk Implications, and Legislative Efforts to Combat the Shortage*, 15 LOY. CONSUMER L. REV. 143, 147 (2003); Shannon Peeples, Note, *The Current Nursing Shortage: Will the Registered Nurse Safe Staffing Act Help?*, 72 UMKC L. REV. 809, 813 (2004); Monte Fried, Commentary, *Will "Safe Nursing and Patient Care Act" Improve Medical Care?*, THE DAILY RECORD (Baltimore, Md.), Aug. 8, 2003, at 1; Rogers et al., *supra* note 72, at 209.

136. *See* Rogers et al., *supra* note 72, at 207.

137. *See The Time Has Come to Deal with Mandatory Overtime*, *supra* note 2 (nurses complaining of sixteen-, twenty-, or twenty-eight-hour shifts and longer).

138. Peeples, *supra* note 135, at 813.

139. *Id.* at 809, 813. Residents and interns also suffer from downsizing and restructuring. *See* Crain, *supra* note 20, at 583-84. As hospitals reduce staffing levels, residents and interns are forced to shoulder the responsibilities once performed by lesser-skilled staff, adding to hours that are already notoriously long. *See id.* at 586-87.

140. Fried, *supra* note 135; Rogers et al., *supra* note 72, at 209; Susan Trossman, *Fighting the Clock: Nurses Take on Mandatory Overtime*, NURSING WORLD, May/June 1998, http://nursing world.org/tan/98Mayjun/ot.htm.

141. *See* Crain, *supra* note 20, at 570-75 (discussing the impact of corporatization, bureaucratization, and restructuring on dramatically increasing billable hour requirements and the attendant undermining of lawyer autonomy and control over time); Cunningham, *supra* note 130, at 979-80 (discussing the impact of increased billable hour requirements on lawyer discontent about having no leisure time). Traditionally, long hours have been strongly embedded in the work culture of law firms as a sign of full commitment to both the firm and one's clients. *Id.* at 983-85. Managing partners in large firms view lawyers who are on part-time schedules as "slackers," and law firm culture "rewards quantity of time at the office." *Id.* Some observers suggest that this is worsening as large law firms are organized more like the corporations that they represent. *See* Crain, *supra* note 20, at 570-71.

142. Crain, *supra* note 20, at 570-71.

form of dramatic increases in billable hour requirements.[143] The billable hour measurement is the most significant instrument that large firms wield to control and measure lawyer output and to quantify the revenue-generating potential of each lawyer.[144] Just as importantly, the billable hour serves as a check on efficiency—since there are upper limits on what a client can be billed—and thus operates to intensify the pace of work. Unprecedented salary hikes for first-year associates in 2000 exacerbated the pressure on billable hours to an extreme.[145] In the wake of these hikes, and despite the most generous compensation packages in history, associates expressed widespread discontent with their long hours and with not having time for themselves or their families.[146] The inability to carve a life outside of work is the primary reason that lawyers have the highest job dissatisfaction rate among most professionals.[147]

The information technology industry is perhaps most emblematic of the converging work conditions between high-wage white-collar and low-wage factory workers. While the public is largely unaware of the "dirtier" side of the industry,[148] the processes of creating and manufacturing new technologies entail forced or involuntary overtime, long hours, declining wages, and job insecurity throughout the chain of production.[149] At the bottom are low-wage women and immigrant workers who assemble computer microchips in semi-conductor and electronic assembly operations under conditions similar to those of garment workers.[150] Higher up the chain are programmers, web developers, systems analysts, and software designers who inhabit increasingly harsh work environments that offer fewer rewards for more work.[151]

Faced with the continual threat of overseas outsourcing, importation of foreign workers,[152] and replacement by contract workers, "permatemps,"[153] and

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143. *Id.* at 571-72; Cunningham, *supra* note 130, at 980-81.

144. Crain, *supra* note 20, at 571-73. The billable hour is also used in accounting and consulting firms to help companies "identify those professionals who fail to work long enough" or fail to bring in sufficient revenue. FRASER, *supra* note 4, at 23-24.

145. Cunningham, *supra* note 130, at 979-80. Law firms have sought to contain the mushrooming costs of associate salaries by contracting out legal work to cheaper lawyers or using paralegals. Crain, *supra* note 20, at 573-74, 577-78. These practices further undermine professional autonomy and institutionalize a super-hierarchy of permanent associates, non-equity partners, contract lawyers, and legal temps. *Id.* at 574.

146. Cunningham, *supra* note 130, at 980 & n.76.

147. *Id.* at 969-70, 980.

148. *See* Ross, *supra* note 20, at 48-49, 52.

149. *See id.* at 49-52. Ross uses the phrase "chain of high tech production" to refer to the hierarchy of workers involved in producing new information technologies, ranging from those who sit at the top of the chain, such as software designers, to those at the bottom engaged in the manufacture and assemblage of products. *Id.* at 50-51.

150. *See id.* at 50-52.

151. *Id.* at 49-50; FRASER, *supra* note 4, at 141.

152. Overseas outsourcing of software jobs and the importation of foreign workers, both of which exert a stiff downward pressure on wages and benefits and upward pressure on hours, are

other contingent workers, skilled hi-tech workers are pressed to work excessive hours at declining wages.[154] The norms in the technology sector are such that a twelve-hour workday is seen as "lightweight" and seventy- to ninety-plus hour work weeks are typical.[155] Workers in the industry often choose longer hours, not to outshine everybody else, but simply to keep up and not be left behind.[156] Similar to low-wage workers in traditional sweatshops, high-tech workers endure frenetic work paces, often without breaks, because of workloads that are too heavy for the deadlines given.[157]

Ironically, new advances in information technology provide employers with greater tools for disciplining and maximizing control over technology and other white-collar workers.[158] Utilizing the concept of "theft of time," which refers to the "misuse of the employer's time and property" by workers,[159] employers justify the proliferation of electronic monitoring of e-mails, computer work, and phone calls.[160] To supervise each worker's activity, automated time-and-attendance video display systems track in-and-out times, enabling an employer to know when someone logs onto a computer, takes a break, or leaves the office.[161] These systems also compute the number of hours worked as well as individual and group levels of productivity.[162]

The trend of compulsory overtime, longer hours, and overwork across the class divide is likely to worsen with regulatory changes spearheaded by a Republican administration. New overtime regulations issued by the U.S.

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integrally linked to employer demands for longer hours. *See* Earnshaw, *supra* note 104. According to high-tech union organizers, "employers prefer H-1B workers because they will put in longer hours than U.S. citizens, because they fear being deported." *Id.*

153. "Permatemp" refers to temps or contract workers who are hired for long periods of time, sometimes even years, in the same job but who are nonetheless treated by the employing firm as contingent workers. FRASER, *supra* note 4, at 141.

154. *See id.* at 137-40 (describing the impact of restructuring on working conditions in the high-tech industry).

155. *Id.* at 22.

156. *See id.* (quoting a software professional explaining the intense peer pressure to keep apace with co-workers' long working hours).

157. *See* BBC News Talking Point, *Hi-Tech Workplaces: No Better Than Factories?* (Nov. 29, 2002), http://news.bbc.co.uk/1/hi/talking_point/2519577.stm (compiling comments of high-tech workers from across the world which resonate common themes such as compulsory or involuntary long hours, increased workloads due to reduced staffing, unpaid overtime, and job insecurity).

158. *See* FRASER, *supra* note 4, at 87-89; Laureen Snider, *Theft of Time: Disciplining Through Science and Law*, 40 OSGOODE HALL L.J. 89, 101-03 (2002).

159. Snider, *supra* note 158, at 90, 97. Snider notes that it is ironic that employers have made so much of workers' theft of time when employers "are increasingly stealing time from employees" through the practice of unpaid compulsory overtime. *Id.* at 109-10.

160. *Id.* at 103; FRASER, *supra* note 4, at 89.

161. Snider, *supra* note 158, at 103; FRASER, *supra* note 4, at 88-89.

162. Snider, *supra* note 158, at 103.

Department of Labor in 2004 expand the definitions of exempt executive,[163] professional, and administrative employees, and loosen what it means to be paid on a salary basis.[164] Organized labor,[165] former Labor Department officials,[166] and other critics of the new regulations[167] warn that these changes will permit employers to classify many employees as exempt who formerly were entitled to the FLSA's protection of time-and-a-half overtime pay. By reducing the cost of overtime, the "de facto elimination" of the right to overtime pay for many workers will invite heavier use of forced overtime by employers, leading to longer hours for greater numbers of workers.[168] As employers are freed from paying for overtime, they will impose more of it, and millions of workers will experience less pay and increased hours of work simultaneously.[169]

II. CLASS-BASED TENSIONS ABOUT OVERTIME

Although workers actively organize around the issue of mandatory overtime,[170] there currently is no mass social movement advocating shorter work

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163. *See* Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, 29 C.F.R. § 541 (2004).

164. *See supra* note 24; *Final Rule on Overtime Pay: Hearing Before the Subcomm. on Labor, Health and Human Services, Education of the S. Comm. on Appropriations*, 108th Cong. (2004) (statement of Tammy D. McCutchen, Administrator, Wage and Hour Division Employment Standards Administration, U.S. Dep't of Labor) (explaining that the new definition of being paid on a salary basis will enable employers to classify many workers as exempt who did not meet the old definition). McCutchen also maintains that the new regulations will widen exemptions for team leaders, low-level managers and assistants, computer professionals, funeral directors, chefs, and financial service workers. *Id.* at 1-3, 4-9.

165. *See* Sweeney Statement, *supra* note 25.

166. Ross Eisenbrey, *Millions to Lose Overtime Pay*, THE MONTANA STANDARD, Aug. 17, 2004, *reprinted in* ECONOMIC POLICY INSTITUTE, VIEWPOINTS, Sept. 10, 2004, http://www.epinet.org/congent.cfm/webfeatures_viewpoints_OT_pay_loss.

167. *See supra* note 24.

168. *See* ROSS EISENBREY & JARED BERNSTEIN, ELIMINATING THE RIGHT TO OVERTIME PAY: DEPARTMENT OF LABOR PROPOSAL MEANS LOWER PAY, LONGER HOURS FOR MILLIONS OF WORKERS 13 (2003) (concluding that employers will schedule more overtime work if they are not required to pay the overtime premium); *cf.* Walsh, *supra* note 24, at 102 (concluding that proposals to permit employers to substitute compensatory time for overtime pay would reduce the cost of overtime and lead to more extensive reliance on overtime by employers).

169. EISENBREY & BERNSTEIN, *supra* note 168, at 13.

170. *See* MOODY & SAGOVAC, *supra* note 80, at 5-7 (describing successful strikes in 1994 over long working hours by UAW auto workers and Teamsters truckers); Michael H. Cimini, *Boeing-Machinists Accord*, MONTHLY LAB. REV., Feb. 1, 1990, at 56 (describing that after a seven-week work stoppage by 57,000 workers, Boeing agreed to reduce mandatory overtime and to increase premium pay to double after 160 hours of overtime in one quarter); Andy Hibberd, *Workers Demand More Family Time*, DERBY EVENING TELEGRAPH (United Kingdom), May 29, 2004, at 5 (noting that Toyota auto workers complain about company's decision to drop plans for a "three-

hours or greater worker control over working time.[171] Specific unions have waged heated strikes over the issue of overtime in the last decade on behalf of workers in particular occupations. These separate struggles have succeeded in catapulting the phenomena of forced overtime and overwork into public view. However, no overarching themes unify the stances of specific unions and groups of workers, nor are attempts made to forge the individual struggles into a larger response. The struggles remain individualized disputes in which protections are won for limited groups of workers.[172]

Working individuals and families must wrestle with the central question of how to inspire a mass movement that empowers workers to claim control over the basic work week.[173] A crucial starting point is the recognition that the issues of overwork and forced overtime present a unique opportunity to unify workers across class, income, and occupation. Yet, to effectively organize across class and occupation, it is necessary that workers struggle to unpack the class-based assumptions that are used to differentiate the experience of overwork and overtime for different groups of workers.[174] As long as these assumptions remain

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shift pattern," which workers welcomed as a step to reduce compulsory overtime and weekend shifts); M. Paul Jackson & Pamela C. Turfa, *OT Issue Tests Many Industries*, THE WILKES-BARRE TIMES LEADER (Pa.), Feb. 23, 2003, at 2 (describing health-care union's national campaign to eliminate forced overtime for employees who provide direct patient care); Kelley, *supra* note 90 (describing overtime and uncompensated overtime work as the workplace conflict of the 1990s); Jim Ritter, *Doc's Hours Hazardous to Your Health? Some Want Government to Limit the Tough Work Schedule of Residents*, CHI. SUN-TIMES, July 31, 2001, at 6 (describing groups' petition to OSHA to limit residents' work weeks to eighty hours to protect residents' health and patient safety); Kalpana Srinivasan, *Verizon Reaches Tentative Contract with Unions*, AMARILLO GLOBE-NEWS, Aug. 21, 2000, *available at* http://www.amarillonet.com/stories/082100/usn_union.shtml (describing agreement reached after a two-week strike over mandatory overtime and the shifting of work to cheaper labor); Anne Trafton, *Pilgrim Security, Union Not Talking*, THE PATRIOT LEDGER (Quincy, Mass.), Aug. 7, 2003, at 9 (describing that security guards at a nuclear power plant rejected their security contractor's mandatory overtime policy and voted to authorize a strike if the dispute was not settled); Wyatt Andrews, *Mandatory Overtime: It's the Law!* (CBS News Broadcast Aug. 31, 2000), http://www.cbsnews.com/stories/2000/08/31/eveningnews (reporting that telephone workers staged a strike over mandatory fifty-three-hour work weeks for four weeks in a row, and noting that mandatory overtime has been a prime issue in almost every recent major strike in 2000).

171. Miller, *supra* note 16, at 4.

172. In addition, various federal and state legislative proposals have been introduced to curb mandatory overtime. *See* GOLDEN & JORGENSEN, *supra* note 6, at 10-14. These proposals, most of which only address workers in the health care occupations, have not progressed very far. *Id.* at 11.

173. *See* RAKOFF, *supra* note 15, at 155 (stating that restoring the balance of life to workers rests in "control over the basic work week").

174. *See* Malamud, *supra* note 20, at 2224-25 (describing the upward identification of white-collar workers and their stance against working hours regulation). Malamud notes that white-collar workers took it for granted that they had to put in overtime to climb up the occupational ladder.

unexamined, workers will have difficulty appreciating the major degree to which working conditions across the class divide have narrowed.

Class status became a fault line that divided workers over the issue of hours regulation during the New Deal era.[175] White-collar workers derived class status, identity, and privilege in distinguishing themselves from manufacturing and service workers who "punched the clock."[176] In the view of white-collar workers, shorter hours and government regulation of their work time undermined professional class status.[177] The FLSA exemptions for professional, executive, and administrative workers resulted largely from the desire of policymakers to preserve the class status and professional identity of white-collar workers.[178]

The challenge today is whether workers up and down the occupational hierarchy will be able to overcome "identifying upward" to recognize that employers have the right and power to make unlimited demands on the non-work time of all workers. Some might argue that high-wage professionals will refuse to ally with blue-collar workers in order to preserve their occupational allegiances and identity.[179] Specifically, professionals may cling to their class status,[180] and continue to view their overtime as an investment rather than as exploitation, especially since they derive greater status from their long hours than factory and low-wage service workers. In addition, it is questionable whether professionals even conceptualize their long hours as overtime; the long hours worked by professionals in comfortable offices or homes may differ qualitatively from the long hours of workers who work in dilapidated factories or impersonal retail stores. These potential barriers to organizing across occupation lead some to suggest that unions can succeed in harnessing the discontent of professionals only if they adopt forms of unionism that reinforce professional identity and interests.[181]

Id. at 2224. Consequently, they did not organize to seek protection from long working hours. *Id.* at 2232; *see also* Crain, *supra* note 20, at 561 (stating that a core aspect of the social class and professional identity of white-collar workers is that as "masters of their time," they do not punch time cards and have control over their work schedules because their work requires judgment and discretion).

175. *See* Malamud, *supra* note 20, at 2219-22 (explaining that the exemption of executive, administrative, and professional workers from the FLSA's overtime provisions was the subject of considerable controversy).

176. *Id.* at 2224.

177. *Id.* at 2224-25.

178. *See id.* at 2285-2315 (containing a detailed historical analysis of how the Wage and Hour Administration under the FLSA engaged in class-based line-drawing to determine who was to be covered by hours regulation).

179. *See* Crain, *supra* note 20, at 597 (arguing that professional workers are fundamentally unwilling to sacrifice class privilege and status by forming allegiances with the working class); Malamud, *supra* note 20, at 2224-25 (observing that white-collar workers identifying "upwards with their bosses" is central to the operation of class stratification in the United States).

180. Malamud, *supra* note 20, at 2317.

181. *See* Crain, *supra* note 20, at 601-04 (positing that since traditional unionism does not

Similar challenges of identification abound for low-wage manufacturing, service, and retail workers. These workers may cling to their class assumption that if they advance up the occupational ladder, the problems of forced overtime and overwork will disappear as they acquire higher status and earn higher incomes. In fact, many low-wage workers may view organizing for shorter hours as incompatible with their interests since long hours may be their main source of mobility.[182] Forming alliances with higher-paid professionals may also feel "unnatural" because of the economic disparities between workers based on occupation and the accompanying assumption that white-collar workers exercise control and choice over their work hours.[183]

It is necessary to challenge these class-based constructions of overwork, overtime, and working hours in order to uncover the common ground between workers with respect to control of time. Many workers are socialized to subscribe to certain class distinctions that may no longer correspond to reality because of the phenomenon of overwork.[184] The converging work conditions across occupation due to overwork and forced overtime present a unique opportunity to expose the common relationship of most workers to capital—namely, that the multiple social responsibilities that workers should be able to fulfill are subordinated to the rhythm of work as defined by employers.[185] In contrast, the goals of traditional unionism—securing improved economic terms such as higher wages and benefits—do not bear the same promise for sustaining alliances between higher-waged and low-wage workers. Tackling class tensions about working hours is a complex undertaking, but has the potential to bring together diverse groups of workers to advance a common agenda of claiming control over work and private time.

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appeal to white-collar workers, unions must reconceptualize themselves according to the model of old media unions that focused on "professional/occupational" identity rather than "work-site" identity).

182. *See* LINDER, *supra* note 10, at 11 (quoting a worker who asks "[d]o you think you can work just 40 hours a week and still buy a house?").

183. *See* Crain, *supra* note 20, at 598 (noting that the working class may be resistant to forming alliances with professionals). Crain refers to a study that found that non-college graduates expressed "a universalistic belief in job entitlement" that clashes with the ethos of individualism espoused by many professionals. *Id.* at 598-99. Crain also points to the incompatibility between the bread and butter issues pursued by traditional unions representing blue collar workers and the goals of preserving occupational identity. *Id.* at 599, 602-03.

184. *See* RAKOFF, *supra* note 15, at 81-82 (arguing that because many executive, administrative, and professional workers no longer control their time and are subject to commodification, it would be sensible to divide this group, which the FLSA treats as one group, "into smaller groups with different characteristics," and to eliminate the FLSA exemption for some of these workers).

185. *See* RAKOFF, *supra* note 15, at 139-41; Schultz, *supra* note 15, at 1936-38 (suggesting that "work-related rights" as part of a reform agenda addressing the tension between work, family, and civic commitments "can unite us across differences and provide a common foundation for equal citizenship for all").

Further, galvanizing a mass social movement around the issue of work time requires a more radical message than the one now offered by organized labor and some women's organizations. In opposition to Republican proposals to reform the FLSA overtime provisions, the AFL-CIO and National Organization for Women (NOW) stake their defense of the overtime provisions on protecting the right of working families to overtime compensation.[186] They maintain that working families cannot afford to lose overtime pay since they depend on the extra income; therefore, the right to overtime compensation must be preserved.

This position of protecting workers' overtime rights recognizes the precarious plight of low-wage families and why some workers desire overtime work. Yet, its shortsightedness outweighs its pragmatism. Even by its own logic, this response is fundamentally too narrow because it fails to address the corrosive effect of systematic overtime on straight wages.[187] Through the creation of an artificial oversupply of labor, overtime leads to wage depression.[188] The more some workers are overworked, the more others are unemployed. Employers then depress base wages as they pit the overworked against the unemployed.[189] In addition, as overtime becomes systematic, employers lower the hourly rate of pay to offset the cost of the overtime premium.[190] Thus, wages earned in a longer workday may, over the long run, fall below wages earned in a shorter workday.[191] In these ways, overtime contributes to the maintenance of low-wage jobs and produces little permanent economic advantage for many workers.

A message predicated mainly on protecting the right of families to work overtime misses the crux of the problem of overwork. Historically, the overtime

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186. *See* Sweeney Statement, *supra* note 25; Statement of Linda Chavez-Thompson, AFL-CIO Executive Vice President, on Overtime Pay (June 2003), http://aflcio.org/mediacenter/resources/a-lct-overtime-06-05.cfm; AFL-CIO, What Workers Are Saying (2003), http://www.now.org/issues/economic/061203olol.html; National Organization for Women, *Department of Labor Rule Change Undermines Overtime Pay Protections* (June 12, 2003) (on file with author); National Organization for Women, *Background: "The Family Time Flexibility Act"* (May 1, 2003), http://www.now.org/issues/economic/060103Familyflex.html.

187. *See* SCHOR, *supra* note 9, at 144 (noting research shows that workers who receive overtime pay earn lower hourly wages as employers "'undo' . . . the effect of the overtime premium"); Smith, *supra* note 15, at 602 (noting empirical evidence that most workers who work mandatory overtime do not receive higher straight time wages than those who work optional overtime). Schor posits that it is probable that wages would rise if overtime work were eliminated. SCHOR, *supra* note 9, at 144.

188. *See* LINDER, *supra* note 10, at 43 (explaining that overtime enables employers to increase the labor supply without adding new workers and thus increases the ranks of the unemployed).

189. *Id.*; It's About TIME!, *supra* note 28.

190. *See* LINDER, *supra* note 10, at 51-55 (discussing how longer hours produces no long-term permanent economic advantage to workers because employers depress base wages to account for the overtime pay premium); Schor, *supra* note 27, at 168 (noting that base wages decline in companies that rely on overtime and that the overtime premium "is in some sense a mirage").

191. *See* LINDER, *supra* note 10, at 54-55 (citing Samuel Gompers in explaining that longer hours may mean lower wages).

premium has failed as a financial deterrent to longer hours, and employers have instead used the premium to induce workers to work longer hours.[192] Ironically, powerful corporations once used this same message—protecting the right of working families to improve their standard of living—to defeat the unions' fight for eight-hour laws that banned overtime work.[193] Corporations continue to appropriate this message to stave off legislation that would end mandatory overtime.[194]

III. CHALLENGING COMPULSORY OVERTIME

A. Taking the Lead from Various Workers' Efforts to Challenge Forced Overtime: The Right to Refuse

It is worthwhile to examine contemporary worker-led efforts at challenging compulsory overtime to formulate a direction for a mass movement for control of working hours. This Article offers two examples—the National Mobilization Against SweatShops ("NMASS") and the nurses' movement to win a right to refuse overtime. Both provide examples of workers who organize to address the destructive impact of long hours on the totality of workers' lives. By calling for a right to refuse overtime, these campaigns seek a shift in the employment relationship that would enable workers to control the boundaries between work time and private time.

1. NMASS.—NMASS is a workers' membership organization founded in 1996 that mobilizes workers and their families around the core theme that "[t]he control of time and the ability to work and live as healthy human beings [is] a fundamental human right."[195] In 2001, NMASS, in conjunction with another independent workers' center,[196] launched "It's About TIME! Campaign for Workers' Health and Safety" ("It's About TIME!"). This campaign focuses on organizing, policy reform, and media advocacy to publicize how compulsory overtime imperils workers' health and safety, hurts women and families, and undermines citizenship.[197]

It's About TIME! grew out of the efforts of low-wage workers who initially came together to organize around the issue of non-payment of wages.[198]

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192. *Id.* at 46. Linder analyzes the "devolution" of the overtime premium from a deterrent to longer hours to an inducement to work longer hours. *Id.* at 44-47.

193. *Id.* at 47-48.

194. *See id.* at 49-50 (noting the statement of a Ford industrial relations manager professing concern that autoworkers rely on overtime pay).

195. Nat'l Mobilization Against SweatShops, *About NMASS*, http://www.nmass.org/nmass/about.html (last visited Oct. 23, 2005) [hereinafter *About NMASS*].

196. The Chinese Staff and Workers Association is a twenty-six-year-old workers' center based in the Chinese communities of New York City whose membership is composed of immigrant workers of all trades, particularly garment, restaurant, and construction.

197. *See* It's About TIME!, *supra* note 28.

198. *Id.*

However, workers very quickly identified long hours and overwork as deadly problems that they wished to address.[199] At governmental hearings, rallies, public demonstrations, and press conferences, It's About TIME! members explain how forced overtime, heavy workloads, and frenetic work paces give rise to debilitating repetitive stress injuries, on-the-job accidents, over-exposure to toxic substances, and other dangerous work conditions.[200] The campaign emphasizes that long hours exacerbate the occupational health hazards of workers in jobs that are already high-risk.[201] Not surprisingly, for immigrants and low-wage workers, who perform the heaviest, dirtiest, and most dangerous work, this means crippling illnesses and accidents, ruined health, and even death.[202] Foreign-born workers have an appreciably higher chance of dying on the job than native-born workers.[203]

Members also bring attention to the special hardships of women and children. Educational materials from It's About TIME! underscore that between putting in long hours at grueling jobs, performing housework, and caring for their children, many women are constantly working.[204] Long hours, chronic stress, and burnout often leads to strained family relationships; "ties to friends and community [also unravel and disintegrate]."[205] Some families "lose track of [their] children" because they have so little time to spend with them.[206] At times, children stop going to school or join gangs because of the lack of parental supervision, or they work and take on family responsibilities when parents become too injured to work.[207]

It's About TIME! also addresses the wider impact of long hours on workers' lives by advocating reform of New York State's workers' compensation system.[208] For many low-wage workers who are injured because of long hours, the workers' compensation system is their only avenue for medical care because

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199. *Id.*

200. *See id.*; *supra* notes 28, 65-66 and accompanying text.

201. *See* It's About TIME!, *supra* note 28; Thomas Maier, *Death on the Job, A Group in Danger: Hispanic Immigrants Face Greatest Workplace Risk*, NEWSDAY, July 25, 2001, at A7 [hereinafter Maier, *Group in Danger*]; Maier, *supra* note 21; Thomas Maier, *Death on the Job: Immigrants at Risk: Dreams Flourish, Then Perish: Lured by Dollars, Many Immigrants Risk Death in Dangerous Jobs*, NEWSDAY, July 22, 2001, at A6 [hereinafter Maier, *Dreams Flourish*]; Port, *supra* note 21.

202. One organizer of garment and restaurant workers explained, "'long hours are the No. 1 killer of people.'" Maier, *supra* note 21.

203. Maier, *Dreams Flourish*, *supra* note 201.

204. It's About TIME!, *supra* note 28.

205. *Id.*

206. *Id.*

207. *Id.*

208. *See* Michael J. Wishnie, *Immigrant Workers and the Domestic Enforcement of International Labor Rights*, 4 U. PA. J. LAB. & EMP. L. 529, 552-53 (2002). The New York workers' compensation system was established to provide workers who become injured or ill during the course of employment with income support and compensation for medical care. *Id.* at 552.

they work in jobs without health insurance coverage.[209] However, extraordinary delays in the adjudication of claims filed with the Workers' Compensation Board[210] often leaves workers with no choice but to continue working until they become too ill to work at all.[211] This typically leads to broken families and a life of pain, poverty, and isolation.

In its short history, It's About TIME! has gained visibility for these issues. It has organized public demonstrations, including a seven-day hunger strike, to demand a statutory right to refuse mandatory overtime and an end to the long delays in the workers' compensation system.[212] Its policy advocacy has resulted in members testifying at a Senate subcommittee hearing on workplace safety and health,[213] as well as the introduction of a bill in the New York State Assembly to prohibit mandatory overtime.[214] The campaign recently won a favorable ruling in a petition filed pursuant to the labor side-agreement to the North American Free Trade Agreement ("NAFTA") that publicized the effects of long hours on workers, and challenged the delays in the workers' compensation system as a failure of the United States to enforce domestic labor laws.[215]

Lessons can be drawn from It's About TIME! about popularizing the need for workers to control their time. The campaign has emphasized that its goals revolve around control of time, not just shorter hours. It has waged an aggressive educational and organizing campaign that offers a broad view of the ruinous impact of forced overtime and long hours on workers and their families and communities. It has involved not-yet-injured young workers and students with older injured workers in a program of mutual aid and support to show that these issues cut across age, education, and occupation.[216] Some of the protests organized by It's About TIME! have been on behalf of recent college graduates who hold white-collar jobs in offices.[217] It's About TIME! also points to the

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209. *See* It's About TIME!, *supra* note 28.

210. *Id.*

211. *See* Thomas Maier, *Death on the Job: Paying Injury's Price: Immigrants Rarely Compensated for Workplace Harm*, NEWSDAY, July 24, 2001, at A4.

212. IT'S ABOUT TIME!, RISING FROM OUR HARDSHIP, STOP THE ATTACK ON OUR HEALTH: HUNGER STRIKE, May 6-13, 2003 (on file with author).

213. *See* Wishnie, *supra* note 208, at 553.

214. A.B. 8260 2003-04 Reg. Assem. Sess. (N.Y. 2003) (on file with author); *see About NMASS*, *supra* note 195.

215. *See* Sam Smith, *Mexico Rips Pataki Over Worker Woes*, N.Y. POST, Nov. 28, 2004, at 10; Amended Petition on Labor Law Matters Arising in the United States Submitted to the National Administrative Office (NAO) of Mexico under the North American Agreement on Labor Cooperation (NAALC) (Oct. 31, 2001) (on file with author); Press Release, Nat'l Mobilization Against SweatShops, Mexico Government Cites N.Y. Gov. Pataki and U.S. for Violating NAFTA, Endangering Workers' Health: Pataki Blamed for Failed State Workers' Comp System (Nov. 24, 2004), http://www.nmass.org/nmass/news/112404NAFTAPressConference.html.

216. It's about TIME!, *supra* note 28.

217. Nat'l Mobilization Against SweatShops, *Life After College: Sweated in the Office*, SWEATSHOP NATION 7 (2003); Nat'l Mobilization Against SweatShops, *The White-Collar*

causes of long hours by drawing connections between those who are overworked and those who are unemployed or who must work in contingent employment because they cannot find full-time jobs.[218]

2. Nurses.—As an occupational group, nurses have had the most success in organizing a sustained national movement to end the practice of mandatory overtime.[219] Through strikes or threats of strikes, several nurses' unions and associations have secured contract language to limit mandatory overtime. Some contracts impose an outright ban on mandatory overtime; others limit the maximum hours in a shift per day, place caps on mandatory overtime hours, or restrict how often a nurse can be required to work overtime in a given period.[220]

Furthermore, the American Nurses Association, state nurses' associations, and nurses' unions have organized aggressively for a statutory right to refuse overtime on both the federal and state levels. In 2001, three bills were introduced in Congress to restrict the ability of hospitals and other employers to require nurses to work beyond certain set hours in a workday or in a fourteen-day period.[221] The purpose of these bills was to curb the power of employers to use mandatory overtime to cover staffing shortages as a normal course of business. Under these bills, employers are also prohibited from firing, penalizing, or discriminating against nurses who exercise the right to refuse mandatory overtime.[222] In addition, ten states have enacted laws that provide nurses with varying degrees of protection from forced overtime, and many other states have introduced similar measures.[223]

Sweatshop: Office Workers Fight Back (2001), http://www.nmass.org/nmass/office%20workers/whitecollar.html.

218. It's About TIME!, *supra* note 28.

219. *See* LINDER, *supra* note 10, at 390.

220. For a more thorough discussion of contract language won by various nurses' unions, see Stan Milam, *Negotiators Far from a Contract*, WIS. ST. J. (Madison, Wis.), Feb. 16, 2004, at D8; Press Release, California Nurses Association, Dameron RNs Ratify New Agreement: Stockton Nurses Win Mandatory Overtime Ban, Economic Gains (Nov. 3, 2000) (on file with author); Press Release, California Nurses Association, No More Mandatory Overtime Long Beach Memorial RNs Reach Agreement (Dec. 8, 2002) (on file with author); Press Release, California Nurses Association, Wage Increases & Ban on Mandatory Overtime Citing Gains, Newly Organized RNs at O'Connor Hospital Ratify New Contract (Sept. 19, 2002) (on file with author); GOLDEN & JORGENSEN, *supra* note 6, at 10 & n.9; Trossman, *supra* note 140, at 4-5.

221. *See* Safe Nursing and Patient Care Act of 2003, H.R. 745, 108th Cong. § 3 (2003); Registered Nurses and Patients Protection Act, H.R. 1289, 107th Cong. § 2 (2001); Patient Care Employees Protection Act, H.R. 1902, 107th Cong. § 2 (2001). As an example of the kinds of protection offered by these bills, the Registered Nurses and Patients Protection Act would amend the FLSA to prohibit employers from requiring any licensed health care employee (not including physicians) to work more than eight hours in any work day or eighty hours in any fourteen-day work period, except in the case of a natural disaster or publicly declared emergency. H.R. 1289, 107th Cong. § 2 (2001).

222. *See* sources cited, *supra* note 221.

223. See LINDER, *supra* note 10, at 379-90, for a detailed discussion of state legislation

The nurses' movement for ending mandatory overtime is instructive even though many of these legislative proposals have stalled. Facing a formidable hospital lobby,[224] nurses have waged a highly visible organizing campaign that singles out long hours, overwork, and forced overtime as major job conditions that threaten their personal and professional lives. They frame forced long hours as a public health issue by documenting how requiring already fatigued nurses to work extra shifts imperils patient health and safety.[225] In addition, the various nurses' associations and unions link the demand to end mandatory overtime to the need for structural changes in the industry that would address chronic understaffing and low nurse-to-patient ratios.[226] Because over ninety percent of the occupation is female,[227] nurses also have added a feminist perspective to these issues by calling attention to how forced overtime and unpredictable long hours with little or no notice undermine their ability as working women to care for their children or sick family members.[228]

To be sure, nurses have successfully garnered political support by capitalizing on the theme of protecting patient health and safety. The regulation of overtime through limits on maximum work hours has been most feasible when public safety is jeopardized by the long hours of a particular occupational group.[229] Protection of the public, rather than the health and safety of workers themselves, is the paramount concern of such legislation. Consequently, some argue that the nurses' movement to gain a right to refuse fails to establish a precedent for other

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limiting forced overtime for nurses in Maine, Oregon, Washington, Minnesota, and New Jersey. Connecticut, California, Maryland, Texas, and West Virginia have also regulated forced overtime for nurses. See GOLDEN & JORGENSEN, *supra* note 6, at 11-14, for a summary of state legislation limiting forced overtime for nurses, health care professionals, and other workers.

224. See LINDER, *supra* note 10, at 381-83, 386-89, for a description of the role of hospital and health care facility lobbyists in the passage of state laws restricting mandatory overtime for nurses in Maine and New Jersey.

225. *See* Anna Burger, Op-Ed., *As I See It: Forced Overtime is Causing Medical Errors*, PATRIOT-NEWS (Harrisburg, Pa.), June 30, 2004, at A13; Fried, *supra* note 135; Byron Kho, *Study: Long Hours for Nurses Make for Poorer Patient Care, More Mistakes*, DAILY PENNSYLVANIAN (University of Pennsylvania), July 29, 2004, *available at* 2004 WL 82208524; Rogers et al., *supra* note 72, at 206-07. Some studies estimate that approximately 20,000 patients die each year because they receive care in a hospital with overworked nurses. Fried, *supra* note 135.

226. *See* Press Release, California Nurses Association, Bill to Ban Mandatory Overtime Clears Senate Panel (Apr. 25, 2001) (on file with author); *The Time has Come to Deal with Mandatory Overtime*, *supra* note 2.

227. Mannino, *supra* note 135, at 147.

228. *See, e.g.*, Press Release, California Nurses Association, CNA-Kaiser Bargaining Update RNs Press Mandatory Overtime Ban, Retention Issues as Contract Deadline Nears with HMO Giant (Sept. 5, 2002) (on file with author); *supra* text accompanying note 2.

229. *See, e.g.*, 49 C.F.R. §§ 395.1, 395.3 (2005) (regulating motor carrier work hours); 49 U.S.C. § 21103 (2000) (limiting on duty hours of train employees); 14 C.F.R. § 65.47 (2005) (regulating maximum hours air traffic controllers may work). See LINDER, *supra* note 10, at 377-78, 385-86, for a brief reference to these and similar statutes.

workers,[230] and that their insistence on the right to work unlimited overtime if they choose is incompatible with the goal of reducing long hours and overwork.[231]

Regardless, nurses are setting a precedent for other workers by challenging fundamental assumptions about who gets to decide whether a worker must work overtime. Although situated within the occupational context of patient safety, the nurses' movement for a right to refuse argues the broader principle that the locus of decision-making about long hours should be shifted to workers. As one nurse put it, "mandatory overtime . . . takes away a basic human right. . . . 'It's a control issue. Working overtime should be a choice.'"[232] Nurses stress that they, not supervisors or administrators, should be the ones to decide whether they are physically or mentally able to work additional hours; they know better than anyone else whether longer hours will hurt their patients. Further, nurses make clear that not only should the decision to work overtime belong to them, but also that they can exercise these choices responsibly.[233] Thus, though nurses fight for a right to refuse within a specific occupational context, they are appealing to broader principles about control of time and respect for workers.

B. The Right to Refuse

Some labor advocates express deep skepticism that a right to refuse can truly empower workers.[234] It has been suggested that in all likelihood, a right to refuse would be of little use to many workers.[235] First, without sufficient resources for

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230. LINDER, *supra* note 10, at 390.

231. *See id.* at 377-78 (noting the difference between "permissive and libertarian" laws that permit needy workers to work longer hours if they choose and "mandatory or coercive" laws that prohibit both employers and workers from eroding hours standards). Linder argues that voluntary overtime, like involuntary overtime, degrades working conditions and other societal norms. *Id.* at 385-87.

232. Trossman, *supra* note 140, at 4.

233. For example, one nurse states, "RNs do not have to be forced to pitch in when a crisis arises. They always volunteer." *Id.* at 5. Even more to the point, another nurse distinguishes between voluntary and forced overtime in this way:

> When you plan on overtime, you plan to be rested and have your children or elderly parent cared for . . . . When the supervisor comes to a nurse after a [twelve]-hour shift and states: "[y]our relief is not coming, you have to stay another four or more hours," a cascade of events, not to mention exhaustion, can (affect) your ability to perform your duties.

LINDER, *supra* note 10, at 385.

234. *See* LINDER, *supra* note 10, at 357-77 (describing failed state efforts to legislate a right to refuse); RAKOFF, *supra* note 15, at 146-49 (describing possible difficulties with framing a statutory right to refuse that contains an exception for emergencies and the reasons why workers might not exercise the right to refuse overtime).

235. RAKOFF, *supra* note 15, at 148-49; *see* LINDER, *supra* note 10, at 469-72 (arguing that Canadian provincial laws guaranteeing a right to refuse mandatory overtime have been ineffectual and workers generally have not availed themselves of these protections).

effective enforcement, the creation of new rights is unlikely to yield concrete gains for workers.[236] Second, the fundamental inequality of the employment relationship renders choice and voluntariness inherently problematic, calling into question whether choice constitutes "genuine" choice.[237] Third, many forces that impinge upon the choice to decline longer hours, both economic and cultural, lie outside the control of workers.[238] For instance, some workers are induced to work overtime by economic necessity or the desire to maintain a certain lifestyle. Others who might wish to decline overtime may refrain from doing so because they do not want to be labeled by employers or co-workers as "slackers."[239]

For these reasons, some suggest that legislated caps on hours in the form of maximum limits on the workday, workweek, or overtime hours, would be a more potent vehicle for preventing employers and workers alike from eroding work time standards.[240] However, the Canadian experience with legislated reduction in hours showed that such laws were frequently so riddled with exceptions that they failed to provide meaningful protection.[241] Admittedly, a similar danger exists with legislating a right to refuse.[242] The real problem is that without a shift in the way society views how decisions about work time should be made, neither the right to refuse nor caps on hours, purely as legislative reforms, is likely to stem the growth of overwork and forced overtime. Perhaps the most essential undertaking of workers in the debate on work time is to use the crisis of overwork to identify core principles about how work time should be structured and organized.

An absolute right to refuse employer demands for long hours, backed by

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236. *See* Walsh, *supra* note 24, at 103-06 (citing studies showing substantial employer non-compliance with the FLSA and inadequate enforcement efforts by the Department of Labor).

237. *See* Belinda M. Smith, *Time Norms in the Workplace: Their Exclusionary Effect and Potential for Change*, 11 COLUM. J. GENDER & L. 271, 282 (2002) (stating that "[p]ressure from employers along with cultural understandings about the workplace and employment limit worker choices and compel them to work longer hours than many would freely choose").

238. *See* RAKOFF, *supra* note 15, at 149 (stating that when the right conferred is the power to make a voluntary choice, many forces may "overwhelm the law's effects").

239. *See id.* (noting that workers are reluctant to assert their rights under the Family Medical Leave Act because of fear of being perceived as slackers); Cunningham, *supra* note 130, at 980 (observing that only 2.9% of lawyers work part-time although ninety-four percent of law firms allow part-time schedules). Cunningham states few lawyers choose to work part-time because of "fear of reduced compensation, decreased advancement opportunities, and diminished workplace reputation." *Id.* at 980. In particular, lawyers are concerned that senior partners perceive those who work part-time as less committed or dedicated. *Id.* at 983-84.

240. *See* LINDER, *supra* note 10, at 460.

241. *See id.* at 418-27 (detailing the history of legislative exceptions and a special permit system that enabled employers to depart from the maximum hour standards established by Ontario's overtime regulation); Brian Alexander Langille, *The Overworked Canadian?*, 70 CHI.-KENT L. REV. 173, 189-91 (1994) (summarizing Ontario's Employment Standards Act and noting that non-compliance by employers is prevalent).

242. RAKOFF, *supra* note 15, at 147.

protection from discrimination in termination, promotion, recruitment, and retention,[243] is a core principle that can help empower workers to claim control of time. This principle is most empowering if conceived within a collectivist rather than individualistic framework. Thus, the right to refuse should be seen as a right to control rather than a right to choose. Resting in a single worker, the right to refuse may be equivalent to a right to choose. However, resting in workers as a group, the right to refuse amounts to a right to control.

Most significant, an absolute right to refuse challenges the presumption in our culture and legal system that employers should control time because they can be trusted to reasonably balance their demands for increased output against the needs of workers. By contrast, the presumption continues that workers cannot be counted on to do the same[244] because workers are too self-interested, irresponsible, and untrustworthy to control the boundaries between work and non-work time. There is a strong tendency both inside and outside of law to equate the preferences of employers with the good of society and to individualize the struggles of workers as the demands of a special interest group.[245] In striking down a New York statute that imposed limits on the maximum weekly work hours of bakers, the Supreme Court in *Lochner v. New York*[246] reinforced the view that protecting workers from excessive hours of work constituted a special interest.[247] An absolute right to refuse long hours represents a cultural and legal

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243. *See* Schor, *supra* note 27, at 171 (supporting a legal right to free time and choice of hours without the threat of discrimination in promotion, recruitment, and retention). Schor argues that promotion, recruitment, and retention should be based on performance, not the number of hours worked. *Id.*

244. *See* Smith, *supra* note 237, at 326 (positing that unemployment cases involving work time disputes are essentially about whether the employer or worker should have the power to decide the importance of competing priorities between employer demands and workers' needs). Smith suggests that much of the unemployment insurance case law reinforces the right of employers to intrude upon workers' private time, and subscribes to the notion that it is too risky to trust workers to weigh competing demands. *Id.*

245. *See id.* at 318 (arguing that a common theme expressed by courts in unemployment insurance cases is that employers are "performing a vital economic function of harnessing labor for production" and "[e]mployers need the freedom, or even have the responsibility, of controlling or regulating their workers in order to run their business and sustain the economy"). Further, the judicial assumption is that workers "would always choose to avoid work if given an opportunity or permission." *Id.* at 317.

246. 198 U.S. 45 (1905), *overruled in part by* Day-Brite Lighting, Inc. v. Missouri, 342 U.S. 421 (1952), *and* Ferguson v. Skrupa, 372 U.S. 726 (1963).

247. Cass R. Sunstein, Lochner*'s Legacy*, 87 COLUM. L. REV. 873, 878-79 (stating that the Court's concern in *Lochner* "was that maximum hour legislation was partisan rather than neutral—selfish rather than public-regarding"). The Supreme Court in *Lochner* found that the New York limitation on working hours of bakers

> involve[d] neither the safety, the morals, nor the welfare, of the public, and that the interest of the public [was] not in the slightest degree affected by such an act. The law must be upheld, if at all, as a law pertaining to the health of the individual engaged in

shift from this belief system and underscores the right of workers to control their time.

CONCLUSION

Overwork and lack of control of time are problems of huge dimensions. Aptly put by one observer, mandatory "overtime—not wages—is ground zero in the labor wars of this new century."[248] The processes of downsizing, lean production, and global competitiveness, all of which have contributed to the growth of compulsory overtime, are not abating.[249] Moreover, overwork and compulsory overtime in the United States has international ramifications and looms over workers across borders. Extolling the United States as the ideal model of a work society, business interests in Germany and France promote longer work hours as the engine for boosting economic growth and productivity.[250] European countries with a strong political, cultural, and social norm of safeguarding workers' leisure time may be poised to reverse that tradition.

These conditions create a unique opportunity for reviving a social movement in the United States that seeks to bring working hours within the sphere of worker control. The phenomenon of overwork and long hours, which is occurring in workplaces that are becoming increasingly autocratic, plagues an ever-widening circle of workers across class, occupation, education, race, sex, and citizenship. Unprecedented numbers of workers find themselves working harder for less, and with little or no time for themselves, their families, or communities. At the same time, long hours through forced overtime helps to maintain low-wages, trapping workers in an endless cycle of overwork and depressed wages. An absolute right to refuse mandatory overtime would be a concrete milestone in the larger project of workers gaining control over the boundaries between work and private time. In turn, greater control of time by workers will facilitate current struggles to increase wages and improve working conditions. Opportunity lies in the challenge of breaking down class divisions to unify diverse groups of workers behind the radical vision that workers should have control of their time.

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the occupation of a baker.

Lochner, 198 U.S. at 57. The Supreme Court thus contributed to splintering the interest of a group of workers in limiting excessive working hours from the interest of the public.

248. Andrews, *supra* note 170.

249. *See supra* notes 78-93 and accompanying text.

250. *See* Katrin Benhold, *Love of Leisure, and Europe's Reasons*, N.Y. TIMES, July 29, 2004, at A10; Mark Landler, *Europe Reluctantly Deciding It Has Less Time for Time Off*, N.Y. TIMES, July 7, 2004, at A1; Carl Bloice, *Left Margin: Less Time Off*, PORTSIDE, July 23, 2004, http://www.portside.org/showpost.php?postid=493.

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NOTES

HOOSIER INHOSPITALITY: EXAMINING EXCESSIVE FORECLOSURE RATES IN INDIANA

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INTRODUCTION

When can dreams quickly become nightmares? The dream of homeownership has now become a reality for more Americans than at any point in history.[1] However, increased emphasis on flexible lending practices and recent national and regional economic slowdowns have turned opportunities for equity-building into recipes for foreclosures and disaster. While different states have been affected to varying degrees, Indiana has undoubtedly been one of the hardest hit by the recent wave of foreclosures.[2]

A foreclosure is a legal mechanism that a lender initiates after a borrower has defaulted on a mortgage.[3] Although the procedures vary depending on state statutory and common law, all foreclosures eventually eliminate all of the borrower-mortgagor's rights in the property. The two primary forms of foreclosure in the United States are judicial foreclosure, which all fifty states

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1. According to the U.S. Census Bureau, the national homeownership rate was 69.2%, the highest in United States history, in the fourth quarter of 2004. *See* Press Release, U.S. Dep't of Commerce, Census Bureau Reports on Residential Vacancies and Homeownership, Table 5 (Jan. 27, 2005), http://www.census.gov/hhes/www/housing/hvs/qtr404/q404tab5.html.

2. In the second quarter of 2002, Indiana's foreclosure rate was the highest in the nation at 2.22%, compared with the national average of 1.24%. *See* Indiana Mortgage Bankers Ass'n, Indiana Mortgage Foreclosure Rate 1 (Jan. 9, 2003), http://www.indianamba.org/Downloads/Indiana%20Mortgage%20Foreclosure%20Analysis%20-%20Jan%2015%2003.pdf (citing Mortgage Bankers Association, *National Delinquency Survey for 2nd Quarter* (June 30, 2002)). By the second quarter in 2004, Indiana's foreclosure rate, now second highest to Ohio, increased to 2.78% while the national average fell to 1.16%. Lesley Mitchell, *Foreclosure Rate Remains High in Utah*, SALT LAKE TRIB., Sept. 9, 2004, at E1.

3. A mortgage is "a conveyance of title to property that is given as security for the payment of a debt or the performance of a duty . . . ." BLACK'S LAW DICTIONARY 1031 (8th ed. 2004).

recognize, and nonjudicial foreclosure, which only some states permit by statute.[4] While foreclosures are a necessary tool for lender-mortgagees to protect their interests, they are always entered into reluctantly because of the excessive costs that they entail.[5]

While the prospect of some mortgages entering into foreclosure is inevitable, the exorbitant number of foreclosures in Indiana is cause for alarm, and its source must be addressed as soon as possible. Various causes of Indiana's poor mortgage performance include the weakened economy, Indiana's high homeownership rate, predatory lending, the lack of equity for borrowers, state foreclosure laws, and the influence of government subsidized loan agencies such as the Federal Housing Administration ("FHA").

Because of the downturn in the national economy, Indiana's job market has weakened considerably in recent years.[6] The collapse of the manufacturing sector, which hit Indiana particularly hard, induced this trend.[7] Nevertheless, Indiana's unemployment rates remain below those of states that have lower foreclosure rates. Implicitly, therefore, it is not the level of unemployment that affects foreclosure rates, but rather how the level of unemployment changes from one period to the next.[8] Nonetheless, when people lose their jobs, they will be less able to pay their monthly liabilities, including their mortgage payments.

Indiana has one of the highest state homeownership rates in the country, even at a time when national homeownership is on the rise.[9] Relatively low home prices and previously low unemployment rates have allowed Indiana citizens to have ownership opportunities that are not available elsewhere.[10] Because of the large number of homeowners in the state, negative developments in the housing market will have a disparate impact on Indiana residents.

One of the most hotly debated topics in lending is predatory lending. Predatory lending practices, such as charging excessive fees or interest rates and performing fraudulent appraisals, exploit the financial situation or lack of

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4. The differences between judicial and nonjudicial foreclosure will be examined in greater detail, *infra* Part I.

5. KAREN M. PENCE, FORECLOSING ON OPPORTUNITY: STATE LAWS AND MORTGAGE CREDIT 1 (2003), *available at* http://www.mbaa.org/industry/reports/03/FRB_Foreclosure_Study_0214.pdf ("[E]stimated losses on these foreclosures range from 30 to 60 percent of the outstanding loan balance because of legal fees, foregone interest, and property expenses.").

6. National Ass'n of REALTORS®, Rising Foreclosure Rates in Indiana: An Explanatory Analysis of Contributing Factors 5 (Mar. 2003), http://www.indianamba.org/Downloads/Realtors%20research.pdf [hereinafter Rising Foreclosure Rates in Indiana].

7. Indiana has one of the highest percentages of workforce participation in the manufacturing sector. Twenty-two percent of Indiana's workforce is based on manufacturing, compared to 14.5% nationally. *Id.*

8. *Id.* at 11.

9. Based on 2000 census data, Indiana's homeownership rate was 74.9%, compared to 67.4% nationally. *Id.* at 5.

10. *Id.*

knowledge of the borrower.[11] In response to concerns that lenders in Indiana are engaging in these practices, the Indiana General Assembly enacted the "Indiana Home Owner Protection Act"[12] in 2004. This bill, which became effective on January 1, 2005, aims at preventing and punishing lenders engaged in predatory lending schemes.

Another reason that Indiana residential mortgages have been more likely to foreclose is that mortgagors have a lack of equity in their homes. Indiana borrowers tend to initiate loans with greater loan-to-value ratios than borrowers in other states.[13] In addition to lower beginning equity, Indiana homes have not appreciated at a rate consistent with the national average.[14] Relatively high rates of new homebuilding activity, seen in most Midwestern states, contribute significantly to this lack of appreciation.[15] Based on basic economics principles, this increase in housing supply causes the average price of the homes to remain constant or decrease over time, as there has not been a proportionate increase in demand. Inevitably, when mortgagors with low equity face foreclosure, they are more likely to concede to the process than a person with a higher amount of equity because they would be less able to sell the property to satisfy the mortgage balance and could face a negative equity position.[16]

The Federal Housing Administration is a government agency that, along with other functions, insures private lenders against possible defaults by mortgagors.[17] Because the FHA has allowed lenders to provide mortgages with higher risk without the fear of losses from default, more people are able to qualify for mortgages. However, because of this added risk, FHA loans are nearly five times more likely to foreclose than conventional loans.[18] While the FHA program is national, Indiana has a higher share of FHA loans than most other states.[19] Because of this heightened presence, the FHA's negative impacts cause

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11. *See* Anna Beth Ferguson, Note, *Predatory Lending: Practices, Remedies and Lack of Adequate Protection for Ohio Consumers*, 48 CLEV. ST. L. REV. 607, 609-11 (2000).

12. 2004 Ind. House Enrolled Act 1229, (effective Jan. 1, 2005), *available at* http://www.state.in.us/legislative/bills/2004/PDF/HE/HE1229.1.pdf.

13. The loan-to-value ratio measures the proportion of debt to equity that a borrower incurs in a loan. According to the Federal Housing Finance Board, in 2002 Indiana mortgagors had five percent less equity in their homes than the national average. Only thirteen states had a higher ratio during that time. Rising Foreclosure Rates in Indiana, *supra* note 6, at 8.

14. According to the Office of Federal Housing Enterprise Oversight, Indiana recently ranked forty-ninth among states in one-year price growth and forty-fifth over a five-year span. *Id.* at 9.

15. *Id.*

16. Negative equity positions can occur when a buyer owes larger transaction fees, such as real estate agent fees, than the low amount of equity they have in the home. *Id.* at 8.

17. U.S. GEN. ACCOUNTING OFFICE, GAO NO. 02-7773, MORTGAGE FINANCING: CHANGES IN THE PERFORMANCE OF FHA-INSURED LOANS 4 (2002), *available at* http://www.gao.gov/new.items/d02773.pdf. [hereinafter CHANGES IN THE PERFORMANCE OF FHA-INSURED LOANS].

18. Rising Foreclosure Rates in Indiana, *supra* note 6, at 7.

19. In 2001, FHA loans comprised twenty-five percent of loans in Indiana, compared to seventeen percent nationally. *Id.*

disproportionate increases in Indiana's foreclosure rate.

Although all of these factors have some influence on the exorbitant foreclosure rates in Indiana, they affect the rate to varying degrees. Some experts consider unemployment to be the largest influence on foreclosures,[20] but policymakers cannot control unexpected changes in the economy. Therefore, analyzing the effect of the economy on foreclosures is futile. In addition, despite the recent actions by the Indiana General Assembly, there is no evidence of higher predatory lending practices in Indiana than in any other state that would cause Indiana's foreclosure rate to be excessively high.[21] On the contrary, according to a 2003 study, the share of FHA loans in a state had the greatest influence on the foreclosure rate and accounted for more than half of the difference between the Indiana rate and the national rate.[22] The way a state structures its foreclosure laws also has a direct correlation on whether it has high or low foreclosure rates.[23] Thus, the two most important, controllable factors that cause Indiana's high foreclosure rate are the state's interaction with the FHA and its statutory procedures for foreclosures.

Part I of this Note examines the varying landscape of state foreclosure laws in the United States. Part II provides background on the FHA, recent problems with high foreclosure rates, and steps that the agency is taking to remedy these problems. Finally, Part III will examine the competing policy concerns surrounding increased homeownership and make suggestions for changes in Indiana statutory foreclosure laws and FHA policies to reduce the number of foreclosures in the state.

I. STATE FORECLOSURE LAWS

Although foreclosure laws vary by state, there are certain basic elements included in every set of statutes.[24] There are two predominant foreclosure

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20. "The most important factor in foreclosures is always employment. And the structural change that we've seen affecting states with a high manufacturing component has been the biggest factor in their unemployment." Interview by Ceci Rodgers with Douglas Duncan, Mortgage Bankers Association of America, *Market Call* (CNN television broadcast Aug. 25, 2004), *available at* http://www-cgi.cnn.com/TRANSCRIPTS/0408/25/lad.03.html.

21. Rising Foreclosure Rates in Indiana, *supra* note 6, at 6. Furthermore, because HEA 1229 did not become effective until 2005, the true impact of predatory lending on Indiana cannot be adequately estimated this early in its implementation.

22. If Indiana had the same share of FHA loans as the average state, its foreclosure rate would be reduced by 0.44%. *Id.* at 7.

23. There is no mandatory national foreclosure law, which allows states to statutorily define their own process. Indiana defines its foreclosure procedures under Title 32 of the Indiana Code. *See, e.g.*, IND. CODE § 32-29-7-1 to -14 (2002). Because of this freedom, states have conflicting provisions that can have varying effects on the frequency and likelihood of foreclosures. These differences are explored later in this Note.

24. There has been widespread support on the benefits of uniform national foreclosure laws. *See, e.g.*, Grant S. Nelson, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53

methods in the United States, judicial foreclosure and nonjudicial (also known as "power-of-sale") foreclosure. Judicial foreclosure entails court adjudication of a lender-mortgagee initiated foreclosure action.[25] In contrast, nonjudicial foreclosure gives the mortgagee the power to sell the mortgaged property to the general public, without court supervision, by placing advertisements.[26] Currently, judicial foreclosure is available in every state, but only approximately sixty percent of states permit nonjudicial foreclosure.[27] A third type of foreclosure, strict foreclosure, is available in only three states.[28]

In addition, states differ in the notice required to mortgagors when they have defaulted or are facing foreclosure. While some states require notice to the mortgagor if they have defaulted on their mortgage or if it is being accelerated, others leave it up to the parties to include such notice requirements in the loan document itself. These notice provisions can reduce the number of foreclosures

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DUKE L.J. 1399 (2004). However, until such a law is passed, state statutes must be examined individually and Indiana should strive to have the most effective and inexpensive foreclosure laws it can.

25. Judicial foreclosure, while time consuming and costly, is the best way to ascertain the rights of the parties involved in the dispute. *See* JON W. BRUCE, REAL ESTATE FINANCE IN A NUTSHELL 199 (1997). However, rights are only finalized once the court confirms the sale of the property, which it will do unless fraud of some sort is shown. *Id.* at 202. Typically, proceeds from any sale cover the expenses of the foreclosure, satisfaction of the mortgage debt, and satisfaction of any junior liens on the property. Any excess proceeds go to the purchaser, and lenders may be able to seek a deficiency judgment to recover personally from the borrower if the proceeds from the sale are insufficient to satisfy the debt. *Id.* at 205. Each state specifically outlines the procedures for judicial foreclosure by statute or common law.

26. When available, lenders almost always use nonjudicial foreclosures because they are quicker and less expensive than judicial foreclosures. However, nonjudicial foreclosures do not have the benefit of being backed by a court order, and courts generally will set them aside for even a slight error in mechanics. Furthermore, some states do not allow lenders to pursue deficiency judgments when they proceed nonjudicially. *See* SIDNEY A. KEYLES, FORECLOSURE LAW & RELATED REMEDIES: A STATE-BY-STATE DIGEST 321 (1995).

27. Nelson, *supra* note 24, at 1403. States that allow either nonjudicial or judicial foreclosure include: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Georgia, Hawaii, Idaho, Iowa, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New York, North Carolina, Oklahoma, Oregon, Rhode Island, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. All other states, including Indiana, require judicial foreclosure. PENCE, *supra* note 5, at 3.

28. Strict foreclosure gives a mortgagor in default a period of time to repay the debt, or their right to redeem the property is extinguished. This result is often viewed as too harsh and unfair, especially when the value of the mortgaged land exceeded the debt owed by the mortgagor. Georgina W. Kwan, Comment, *Mortgagor Protection Laws: A Proposal for Mortgage Foreclosure Reform in Hawai'i*, 24 U. HAW. L. REV. 245, 248-49 (2001). Currently, only Connecticut, Illinois, and Vermont allow strict foreclosure, and the requirements for each state differ. *See generally* CONN. GEN. STAT. § 49-15 (1998); 735 ILL. COMP. STAT. 5/15-1403 (2004); VT. STAT. ANN. tit. 12, § 4531 (2002).

because many homeowners are not aware they are in default until they receive such notice, allowing them to cure the default at that time.

Finally, some states grant homeowners a right of redemption, while others limit or remove the right.[29] Statutory rights of redemption grant mortgagors a period of time after a foreclosure in which they may reclaim the property through payment of the foreclosure sale price or delinquent amount.[30] These different combinations shift the balance between being considered a creditor-friendly or a lender-friendly state and affect the number and efficiency of foreclosures in the state.

A. Indiana Foreclosure Law

Indiana's statutory framework for the foreclosure process affects its abnormally high foreclosure rates. Before drawing comparisons between Indiana's laws and those of other states and finding possible nexuses between certain rules and higher occurrences of foreclosures, it is important to understand how Indiana deals with these events. Surprisingly, even though Indiana consistently has high foreclosure rates, its foreclosure laws tend to favor borrower-mortgagors over lender-mortgagees.

As with all other states, Indiana allows judicial foreclosure, but Indiana does not permit power-of-sale foreclosure.[31] If the court finds in favor of the mortgagee, Indiana Code section 32-29-7 governs the sale of the property through judicial foreclosure in the state.[32] Because mortgagees are not able to sell

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29. All states give borrowers an equity right of redemption, which developed from common law. However, this equitable right expires at the time of foreclosure. Therefore, some states offer additional statutory rights of redemption to a varying extent after foreclosure is completed. Currently, the following states grant a statutory right of redemption in some form: Alabama, Alaska, Arkansas, California, Colorado, Idaho, Illinois, Iowa, Kansas, Kentucky, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Oregon, Rhode Island, South Dakota, Tennessee, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. PENCE, *supra* note 5, at 3.

30. These redemption laws are designed to protect against sales of the property in question at a price far below its actual value and give more time to allow the mortgagor to obtain necessary funds to retain the land. These statutes often vary in the time period allowed for redemption and whether they even apply to nonjudicial foreclosures. Redemption statutes often come under fire because many believe they do not protect against underbidding. The purchaser must wait for the statutory time to ensure they actually own the property, so it reduces the price they are willing to pay. *See* BRUCE, *supra* note 25, at 215. Currently, there are only eight states that absolutely disallow redemption rights: Arizona, Hawaii, Louisiana, Montana, New York, Pennsylvania, South Carolina, and Texas.

31. Pursuant to Indiana statute, "[t]he sale of mortgaged property by the mortgagee may only be made under a judicial proceeding." IND. CODE § 32-29-1-3 (2002).

32. Court orders to file a sheriff's sale must wait three months after filing of the foreclosure complaint. *Id.* § 32-29-7-3(a). There are exceptions to this lag period when the property has been abandoned, in which case a writ of sale may be executed on the date of the judgment according to

property without supervision, the statute provides mortgagors more protection against potential fraudulent or inequitable actions taken by mortgagees. Furthermore, Indiana's judicial foreclosure process also protects homeowners by allowing them to remain in their homes, rent free, until the process is completed.[33]

Once a homeowner neglects to make a payment to the mortgagee or perform some other obligation pursuant to the terms of the mortgage, he or she is in default on the mortgage.[34] At that point, the mortgagee may accelerate the loan to make it immediately payable in full.[35] Indiana's foreclosure statutes draw a distinction between these events, as it does not require notice of default to delinquent property owners, but the lender must give notice of acceleration of the loan.[36] While this provision does not fully protect mortgagors, it is more borrower-friendly than many states that do not require the lender to notify the borrower at any point in the process.[37]

Another component of Indiana's statutory scheme partially grants power to borrowers involved in a foreclosure proceeding. Prior to a court authorized foreclosure sale, a mortgagor may redeem the property from the judgment by paying the amount of the judgment, plus interest, and the costs of procuring the judgment.[38] However, unlike in some other states, once a foreclosure sale has been completed, there is no statutory right of redemption.[39] This limited protection benefits homeowners in some regards, but the pre-sale right of redemption likely has little impact or practical use.[40]

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section 32-29-7-3(a)(2), or when the owner has waived the time limit under section 32-29-7-5. Because of these time limits, even in an uncontested case, the time to complete the foreclosure process will average about six months, including three months until the writ is permitted, six to eight weeks to date of sale, and two to four months for judgment on the sale. *See* KEYLES, *supra* note 26, at 168. There are many other particularities of the Indiana Code dealing with judicial foreclosure, but they are not relevant for purposes of this Note.

33. This protection does have some limitations to protect against abuse by mortgagors. The mortgaged property must be occupied by the mortgagor, the mortgagor must not damage the premises in any way, and the mortgagor must continue to pay taxes and assessments while they remain in the home. IND. CODE § 32-29-7-11(b) (2002).

34. Michael Guisto, Note, *Mortgage Foreclosure for Secondary Breaches: A Practitioner's Guide to Defining "Security Impairment,"* 26 CARDOZO L. REV. 2563, 2565 (2005).

35. *Id.* at 2564.

36. This difference in notice requirements is due to the severity of acceleration compared to default. Notice is required for acceleration because it is the triggering mechanism that begins the foreclosure process, whereas a lender may not begin foreclosure merely upon default. *See* KEYLES, *supra* note 26, at 167.

37. *See, e.g.*, OHIO REV. CODE ANN. § 2329.23 (LexisNexis 2002).

38. IND. CODE § 32-29-7-7 (2002).

39. *In re* M & L Farms, Inc., No. 96-10012, 1996 Bankr. LEXIS 1921, at *9-10 (Bankr. N.D. Ind. Apr. 1, 1996) (interpreting Indiana Code section 32-29-7-13 to forbid post-sale right of redemption).

40. Typically, common law rights of redemption are not exercised. Borrowers have no

B. Foreclosure Law in States with High Foreclosure Rates

In the past few years, many other states in addition to Indiana have suffered high foreclosure rates. Four states that have consistently had the highest foreclosure rates in recent times are Ohio, South Carolina, Pennsylvania, and Mississippi. Although these states are geographically diverse, there are consistencies in their statutes that raise possible correlations between their impact on the mortgage market and higher occurrences of foreclosure.

Although Ohio has consistently had high foreclosure rates in the past few years, it recently reached the dubious distinction of having the highest foreclosure rate in the country at 3.33%.[41] Not surprisingly, many of Ohio's foreclosure laws are similar to the laws in Indiana. All foreclosures in Ohio utilize judicial foreclosure.[42] Similarly, the mortgagor only has redemption rights until confirmation of the foreclosure sale.[43] One difference between Ohio and Indiana is that, unless enumerated and required in the loan documents, Ohio does not require notice of default or acceleration.[44] Nonetheless, the basic legal framework in Ohio and Indiana is similar and is a contributing factor in each state's recent high foreclosure rates.

South Carolina, which recently had the third highest foreclosure rate of 2.46%,[45] also has laws similar to those in Indiana. South Carolina only permits judicial foreclosure in the state.[46] Furthermore, while Indiana only allows redemption before the foreclosure sale, South Carolina completely forbids a mortgagor's statutory right of redemption.[47] South Carolina's rules regarding notice are similar to those in Ohio, because they only require notice of acceleration if the mortgage explicitly provides for it.[48]

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incentive to redeem the property when its value is lower than the amount owed on the loan, which is what most often leads to foreclosure. PENCE, *supra* note 5, at 6. Nonetheless, even if the value of the property is higher than the amount on the loan, there is likely nothing that has changed in the short-term that would enable the borrower to financially support the redemption of the property.

41. Mitchell, *supra* note 2, at E1.

42. Nonjudicial foreclosures are permitted if they are by a trustee pursuant to a deed of trust. However, this exception is never used because there is no judicial determination of title. Therefore, Ohio is exclusively a judicial foreclosure state. *See* KEYLES, *supra* note 26, at 443.

43. OHIO REV. CODE ANN. § 2329.33 (LexisNexis 2002).

44. In Ohio and states where no notice of default or acceleration is required, the filing of a foreclosure action with the court, which will entail service upon the party involved, will serve as sufficient notice. *See id.* § 2329.23.

45. Mitchell, *supra* note 2, at E1.

46. *See* S.C. CODE ANN. § 15-7-10 (2004).

47. *See* KEYLES, *supra* note 26, at 495.

48. Because judicial foreclosure is the only method in South Carolina, the service of a court summons and complaint for foreclosure is an adequate notice of acceleration when it is not enumerated in the mortgage. Hendrix v. Franklin, 355 S.E.2d 273, 274 (S.C. Ct. App. 1986).

Pennsylvania, another state with a high foreclosure rate,[49] continues the trend, with laws parallel to Indiana's statutory scheme. Pennsylvania is an exclusively judicial foreclosure state and ends a mortgagor's right of redemption after the completion of a sheriff's sale of the foreclosed property.[50] Conversely, Pennsylvania does not require default and acceleration notices where the principal on the loan exceeds $50,000, but requires thirty days notice before acceleration or the commencement of legal action for residential mortgages that are below that amount.[51] Pennsylvania's notice provision is evidence of the infinite statutory variations that exist among states.

Mississippi has shared similar problems with high foreclosure rates in the past few years, where 2.27% of mortgages in the state foreclosed in the second quarter of 2004.[52] However, unlike most other states with high rates, Mississippi is a nonjudicial (or power-of-sale) foreclosure state.[53] Because the state permits nonjudicial foreclosures, lenders rarely use judicial foreclosures unless there is an error in the deed that prevents a nonjudicial foreclosure.[54] In fact, most of Mississippi's laws make the state more pro-lender than other states with high foreclosure rates. Except in some cases where there was course of dealing between the mortgagor and mortgagee, Mississippi does not require written notice of either default or acceleration.[55] Furthermore, redemption rights are only available before a valid foreclosure sale.[56]

C. Foreclosure Law in States with Low Foreclosure Rates

At the same time that the national foreclosure rate has been on the rise and at all-time highs, some states have managed to keep foreclosures to a minimum. Although some uncontrollable factors such as geographic location can affect a state's ability to limit foreclosures,[57] the structure of the laws of these states also

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49. Pennsylvania's foreclosure rate for the second quarter in 2004 was 1.94%. Mitchell, *supra* note 2, at E1.

50. PA. R. CIV. P. 1141 (2004).

51. 41 PA. CONS. STAT. § 101 (2004). The likely justification for this distinction is that borrowers are more likely to be able to pay off the balance of their mortgage when it is below a certain amount, and the state may see it unjust to strip a homeowner of their property without time to react when they are close to having full equity in the property. In addition, low-income mortgagors are more likely to have lower mortgage amounts and be in need of extra protection from the state.

52. Mitchell, *supra* note 2, at E1.

53. *See* MISS. CODE ANN. § 89-1-55 (1999).

54. KEYLES, *supra* note 26, at 319.

55. *Id.*

56. MISS. CODE ANN. § 89-1-59 (1999).

57. The foreclosure rate among regions of the United States can vary drastically, even though economic conditions and foreclosure laws may be the same. In the fourth quarter of 2004, the foreclosure rate in the North Central region of the United States was 1.75%, whereas the foreclosure rate in the West region was only 0.68%. Press Release, Mortgage Bankers Association, Residential

contributes to their relative success. Over the past few years, states such as California, Alaska, New Hampshire and Wyoming have enjoyed foreclosure rates well below the national average.[58]

California, like most states with low foreclosure rates, allows nonjudicial foreclosure.[59] Although nonjudicial foreclosures are completed without court intervention, they are still included in the calculation of state foreclosure rates.[60] Also, unless the loan agreement provides otherwise, California does not require notice of default, but does require notice of acceleration unless the agreement expressly states that the lender has the right to accelerate the debt.[61] This provision gives lenders the right to control their mortgages at the outset, a benefit not given to unknowledgeable borrowers. California permits redemption until the completion of a foreclosure sale, which does give some power to mortgagors.[62] Because of California's "unique" real estate market, it is likely that these foreclosure laws have less of an effect on its foreclosure rates than those in other states.[63]

Alaska similarly permits nonjudicial foreclosure, which is the primary foreclosure method in the state.[64] Like many power-of-sale foreclosure states with low foreclosure rates, statutory rules differ depending on whether the lender pursues the foreclosure judicially or nonjudicially. For example, Alaska does not require written notice of default and acceleration for judicial foreclosure, but does require notice of default for nonjudicial foreclosure.[65] Also, the mortgagor has redemption rights for nonjudicial foreclosure, but not for judicial foreclosure. These distinctions strike a balance between the power that nonjudicial foreclosure gives to lenders and the need to protect borrowers from this extra

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Mortgage Delinquencies Continue to Fall While Foreclosures Increase Slightly According to MBA's National Delinquency Survey (Mar. 11, 2004), *available at* http://www.mbaa.org/news/2004/pr0311a.html.

58. As of the third quarter in 2002, the national average was 1.15%, compared to California (0.5%), Alaska (0.4%), New Hampshire (0.4%), and Wyoming (0.5%). Rising Foreclosure Rates in Indiana, *supra* note 6, at 15-16.

59. *See* CAL. CIV. CODE § 2924 (West 2004).

60. Reports such as the Mortgage Bankers Association delinquency surveys cover all government-insured and conventional loans in their results.

61. KEYLES, *supra* note 26, at 37.

62. *Id.* at 42.

63. *Golden West Financial Corp.*, SAN FRAN. CHRON., Jan. 18, 2004, at I1. As opposed to Midwest states where farmland may easily be purchased and developed, California has limited residential space. This has led to appreciation of property values and a "seller's" market. "One big market driver is that housing demand is greater than supply." Alec Rosenberg, *Home Prices Creep Up: Bay Area Housing Market Stays Hot But Increases May Slow Down*, DAILY REV. (Hayward, Cal.), Sept. 17, 2004. Because property values largely remain above mortgage balances in California, fewer foreclosures occur, and those who do face financial difficulty are easily able to sell their homes to a willing buyer at an inflated price.

64. *See* ALASKA STAT. § 34.20.090 (2004).

65. *Id.* § 34.20.070.

power, which may lead to potential fraudulent actions by lenders.

In addition to its geographic difference, New Hampshire's statutory foreclosure scheme differs from these other states. Unless the loan explicitly provides otherwise, the state does not require notice of default or acceleration.[66] New Hampshire permits nonjudicial foreclosure, but it also permits three additional special methods of foreclosure: entry under process, entry and publication, and possession and publication.[67] New Hampshire, as with all states, allows a common law equitable right of redemption until a foreclosure sale, but does not offer statutory redemption rights under any foreclosure method after such a sale.[68]

Finally, Wyoming also allows nonjudicial foreclosure.[69] Despite this similarity with other low foreclosure rate states, Wyoming's other laws differ from the other low foreclosure states in many ways. For example, Wyoming requires both notice of default and acceleration by statute,[70] and redemption rights exist for mortgagors under both judicial and nonjudicial foreclosure for a period of three months from the date of the foreclosure sale.[71] These notice provisions and redemption rights are again mitigating protection against the broad power that nonjudicial foreclosure gives lenders.

Despite the subtle differences among the laws of states with high foreclosure rates, most are judicial foreclosure states that tend to favor the borrower. On the other hand, states with low foreclosure rates tend to favor the lender, or at least strike a better balance between the two parties. While it appears contradictory that there would be more foreclosures in a state where the borrower is at an advantage, Part III.B of this Note addresses the many reasons for this relationship.

II. THE FEDERAL HOUSING ADMINISTRATION

A. Overview of the FHA

The National Housing Act led to the establishment of the Federal Housing Administration in 1934.[72] Created in reaction to the Great Depression, the main goal of the FHA was to further homeownership, protect lenders, and increase

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66. KEYLES, *supra* note 26, at 373.

67. N.H. REV. STAT. ANN. § 479:19 (2004). Entry under process is valid by lawful entry and possession of the property in question for one year. Entry and publication entails "peaceable" entry onto the property, possession for one year, and publication for three consecutive weeks in a newspaper of general circulation in the property's county. Possession and publication is used when the lender already has possession of the property and similar publication is used as under "entry and publication."

68. *Id.*

69. *See* WYO. STAT. ANN. § 34-4-102 (2003).

70. *Id.* § 34-4-103.

71. *Id.* § 1-18-103(a).

72. 12 U.S.C. § 1701 (2000).

employment in the building industry. The program accomplishes these goals by insuring private lenders against losses on mortgages that finance purchases of property with one to four housing units, up to certain principal amounts.[73] Because the insurance subjects lenders to less risk, they are more willing to give mortgages to borrowers who otherwise would have been too financially unstable to qualify. The FHA became part of the Department of Housing and Urban Development's ("HUD") Office of Housing in 1965 and remains under the authority of that department today.[74] HUD also oversees the Fannie Mae and Freddie Mac corporations, both of which the FHA references in determining loan limits.[75]

The FHA is a self-sufficient agency with its own funding through the Mutual Mortgage Insurance Fund ("MMIF"). Insurance premiums and proceeds from the sale of foreclosed properties cover the payments of claims by lenders on foreclosed properties and other administrative expenses.[76] To ensure that this fund does not get depleted, the FHA's underwriting guidelines require lenders to evaluate and limit risk. Lenders evaluate a borrower's ability and willingness to pay by evaluating qualifying ratios, stability and adequacy of income, credit history, and funds to close on the sale.[77] Despite these protections, the FHA continues to have a detrimental impact on foreclosure rates across the nation.

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73. CHANGES IN THE PERFORMANCE OF FHA-INSURED LOANS, *supra* note 17, at 4. Borrowers pay insurance premiums, often as part of their monthly payment, to cover the cost of the FHA's insurance to lenders. According to HUD's website, insurance costs drop dramatically after the longer of five years or when the balance of the loan is less than seventy-eight percent of the property value. HUD Website, http://www.hud.gov/offices/hsg/fhahistory.cfm (last updated June 27, 2005).

74. *Id.*

75. Both Freddie Mac and Fannie Mae are stockholder-owned corporations that provide funding to lenders to ensure they continue to offer mortgages to high-risk borrowers. Both entities are far too complex to discuss in detail for purposes of this Note. To limit its potential losses, the FHA sets loan limits on the mortgages it insures based on a percentage of area home prices, which protects against regional discrepancies in home prices. Historically, limits were set at ninety-five percent of the median home sale price within a county and between thirty-eight and seventy-five percent of the loan limits for Freddie Mac or Fannie Mae purchased loans. These limits have recently increased, as discussed later in this Note.

76. CHANGES IN THE PERFORMANCE OF FHA-INSURED LOANS, *supra* note 17, at 5. The fund is increased by insurance premiums from borrowers at the beginning of the mortgage and periodically over its life and by proceeds from the sale of foreclosed properties insured by the FHA. Although the fund is backed by the U.S. Treasury, the FHA would only rely on treasury funding if and when it depleted the MMIF.

77. *Id.* at 7. For a full discussion of these factors, including the changes made to them in the 1990s, see *infra* notes 82-85 and accompanying text. The FHA has not recently changed the amount of funding required at the beginning of a mortgage, but the general trend in the mortgage market has been towards lower down payments to encourage higher levels of homeownership.

B. Impact of the FHA on Foreclosure Rates

Throughout the 1990s, FHA loans grew increasingly more likely to foreclose.[78] When combined with the higher number of borrowers obtaining FHA loans, this had a profound negative impact on the national residential mortgage market. A number of factors contributed to increased FHA foreclosure rates, including changes in underwriting requirements by the FHA at a time when the conventional mortgage market was growing and there was price appreciation for residences.[79] These underwriting requirement changes aimed to "expand homeownership opportunities by eliminating unnecessary barriers to potential homebuyers," but instead, the FHA became overwhelmed with high-risk borrowers.[80] Part III.A of this Note fully examines this type of tradeoff, which is the topic of ongoing debates in the housing arena.

In 1995, the FHA made a number of changes that allowed more people to acquire funding for homes through FHA programs for the first time and increased the amount for which these borrowers could qualify. The underwriting requirements changed in four key areas, each increasing the loan amount for which individuals could qualify.[81] The FHA restricted the definition of "long-term debt," which often reduced the amount of debt included in qualifying ratios.[82] The FHA also expanded the definition of "effective income," so that previously unusable forms of income are now relevant for purposes of the FHA's qualifying payment-to-income ratio.[83] Aside from the qualifying ratios, the FHA

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78. *Id.* at 2. A sign of the problems in the program, even FHA adjustable-rate mortgages had increasing foreclosure rates at a time in the 1990s when mortgage interest rates were either stable or declining. *Id.* at 10. Adjustable-rate mortgages tie the interest paid for the mortgage to a market index. Therefore, even though mortgage payments would theoretically fall during this time, more people were defaulting and losing their homes.

79. *Id.* at 3.

80. *Id.* at 22. FHA loans are more likely to be issued to low-income, minority, or first-time homeowners who would otherwise not qualify for a loan due to possible poor credit records or the fact that they live in an underserved neighborhood. *See* U.S. DEP'T OF HOUS. AND URBAN DEV., ISSUE BRIEF NO. IV, FHA'S IMPACT ON INCREASING HOMEOWNERSHIP OPPORTUNITIES FOR LOW-INCOME AND MINORITY FAMILIES DURING THE 1990S 3 (2000), *available at* http://www.huduser.org/publications/pdf/fha.pdf [hereinafter FHA'S IMPACT ON INCREASING HOMEOWNERSHIP OPPORTUNITIES].

81. CHANGES IN THE PERFORMANCE OF FHA-INSURED LOANS, *supra* note 17, at 22.

82. *Id.* at 23. The qualifying ratio is the debt-to-income ratio, which must not be higher than forty-one percent to qualify for an FHA-insured loan. Items such as childcare expenses, which previously were required additions to debt calculations, no longer must be included. In addition, long-term debts previously included debts extending sixth months or longer, but the new guidelines only include debts extending ten months or more. Thus, for many borrowers, less debt was included in their debt-to-income ratio, and they were able to meet the forty-one percent threshold for the first time.

83. *Id.* at 24. Mortgage payments under the payment-to-income ratio may not exceed twenty-nine percent of a borrower's monthly income. Thus, additional income items enable more people

also increased the number of compensating factors that may nonetheless approve a borrower for a loan amount.[84] Finally, the FHA relaxed the standards for evaluation of past credit history, allowing some people with previously poor credit to qualify for new mortgages.[85]

At the same time the FHA relaxed these underwriting requirements, Congress raised loan limits for FHA loans to forty-eight and eighty-seven percent of the conforming loan limit.[86] This change came at HUD's request, again in line with its goal to give more families the ability to use the FHA for their mortgages.[87] While this change did allow more people to obtain FHA-insured loans, these loans carried higher principal values than the FHA had dealt with previously,[88] which can lead to larger losses for the MMIF if borrowers are unable to fulfill the terms of their mortgages.

Finally, competition from the private mortgage insurance market also increased while the FHA was changing its requirements.[89] These private insurers serve essentially the same purpose as the FHA, offering mortgages with low down payments to borrowers who may not be otherwise qualified, but whom the insurer sees as a low-risk borrower.[90] Borrowers often prefer private mortgage insurance, if attainable, because it is less expensive than FHA insurance.[91] In the

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to qualify for loans and for higher loan amounts. When calculating income, lenders balance the amount of anticipated income with the likelihood the income will continue. The underwriting changes now allow certain types of income that were previously considered too volatile to be included, such as overtime and bonuses. In addition, income must now only be expected to continue for three years, when in the past it must have met a five-year mark.

84. *Id.* While the qualifying ratios discussed above serve as guidelines for lenders to follow, borrowers are not completely barred from FHA-insured protection if they do not meet the stated percentages. The new underwriting standards included several new compensating factors that lenders may weigh in determining solvency. Lenders may now include public benefits, such as food stamps or welfare, in the borrower's ability to pay. In addition, if a borrower has shown an ability to pay housing expenses greater than those allowed in the past, lenders may allow the increased amount.

85. *Id.* at 25. Before the underwriting changes, borrowers were unable to qualify for FHA-insured loans if they were delinquent on any federal debt or liens on any property. However, the FHA will now qualify such individuals. In addition to traditional credit reports, lenders were previously only permitted to use rent or utilities as a nontraditional way of showing good credit. The underwriting changes now allow other nontraditional credit reports as well, which consider periodic payments such as tuition, insurance, and medical bills. These changes essentially allow lenders to choose what credit history casts the borrower in the best light and then approve them for mortgages to be insured by the FHA.

86. FHA'S IMPACT ON INCREASING HOMEOWNERSHIP OPPORTUNITIES, *supra* note 80, at 6. At these levels, the FHA insures homes with prices between $132,000 and $239,250.

87. *Id.*

88. CHANGES IN THE PERFORMANCE OF FHA-INSURED LOANS, *supra* note 17, at 3.

89. *Id.* at 26.

90. *Id.* at 22.

91. *Id.* at 26.

past, the FHA had an advantage over these private insurers because it was able to identify low-risk borrowers more effectively. However, as the competencies of the private market have increased, private mortgage insurance companies have been able to identify and select the lower risk would-be mortgagors. The would-be mortgagors that remain for the FHA are higher-risk insureds, leading to higher foreclosure rates for the program.[92]

In the end, the FHA's internal changes conflicted with the changing external mortgage market, which forced the FHA to reevaluate its goals and policies. While the dream of homeownership for all had been, and continues to be, a noble ideal of the FHA, its achievability was called into question in the 1990s and the agency took action to reduce the growing number of foreclosures it faced.

C. Steps Taken by FHA to Reduce Foreclosure

In November 1996, the FHA finally reacted to its foreclosure problems. Recognizing that foreclosure is often unavoidable, the FHA instead implemented a program aimed at loss mitigation. This program provided a variety of alternatives, each seeking to help borrowers avoid foreclosure or dispose of their property in cost-effective ways for the FHA and the borrower.[93] The FHA supports three types of loss mitigation that enable borrowers to remain in their homes: special forbearance, loan modification, and partial claims.[94] If none of these options is available or feasible, the FHA encourages the borrower to either perform a pre-foreclosure sale or deed-in-lieu of foreclosure.[95] The FHA expects

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92. *Id.* In addition, the competition has raised concerns over the future funding of the MMIF. As the "FHA's claims rate . . . continues to rise each year and with fewer FHA mortgage applicants there is less premium income to cover the claims." *Mortgage Fraud and Its Impact on Mortgage Lenders: Before the Subcomm. on Housing and Community Opportunity of the H. Comm. on Financial Services*, 108th Cong. 1 (2004) (prepared testimony of Hon. Kenneth M. Donohue, Sr., Inspector General, Department of Housing and Urban Development), http://financialservices.house.gov/media/pdf/100704kd.pdf.

93. CHANGES IN THE PERFORMANCE OF FHA-INSURED LOANS, *supra* note 17, at 22 n.15.

94. Special forbearance allows borrowers a period of suspended or reduced payments and an additional grace period to repay the arrearage of the delinquent mortgage. *See* 24 C.F.R. § 203.614. This option is typically only offered when there is a reasonable chance the borrower can resume normal payments in the future. Loan modification changes the mortgage to lower interest rates or extended mortgage terms in order to lower payment amounts. *See id.* § 203.616. Partial claims involve one-time payments from the FHA to the borrower to make the mortgage balance current. *See id.* § 203.371. Partial claims are offered when borrowers have long-term financial stability to cover their mortgage but are not able to cure the outstanding delinquency. U.S. DEP'T OF HOUS. AND URBAN DEV. MORTGAGEE LETTER 96-25, EXISTING ALTERNATIVES TO FORECLOSURE-LOSS MITIGATION (1996), *available at* http://www.hudclips.org/sub_nonhud/html/ shortcut.htm (follow "1996" hyperlink under Letters: Mortgage then locate letter 96-25) [hereinafter MORTGAGE LETTER 96-25].

95. MORTGAGE LETTER 96-25, *supra* note 94. These mitigation techniques do not allow the borrower to keep their property, but are still seen as cost-effective alternatives to foreclosure. Pre-

lenders to choose the appropriate mitigation tool on a case-by-case basis, depending on the extenuating circumstances and delinquency of payment (in terms of both time and amount), once a mortgagor has not made three full monthly payments.[96] While the FHA's loss mitigation program is not mandatory for lenders, the FHA does provide incentives for lenders to take part in the program, in addition to possible financial penalties for non-participation.[97] As of 2000, the loss mitigation program appeared to be a success, with more lenders participating in the program and the number of foreclosures falling.[98]

The FHA is also reacting to the increased competition from the private mortgage insurance sector. It has begun implementation of automated underwriting systems, designed to provide consistency and effectiveness in the FHA's underwriting practices.[99] These systems, designed to better distinguish between higher and lower credit risks, will attempt to lower the FHA's risk portfolio.[100]

However, these loss mitigation strategies and automated systems are not long-term solutions to the increasing foreclosure problems of the FHA. Pre-foreclosure sales and deeds-in-lieu of foreclosure prevent statistical foreclosures, but, undesirably, families are still stripped of their homes. The automated underwriting systems run against the goal of the FHA to provide housing to as

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foreclosure sales attempt to cover the outstanding mortgage amount for the lender much like the nonjudicial foreclosure process. *See* 24 C.F.R. § 203.370. Just as redemption rights are designed to prevent lenders from buying foreclosed properties for inadequate amounts, the FHA imposes a floor on the pre-foreclosure sale price, eighty-seven percent of the value of the property. If this bar is met, the FHA will reimburse the lender for the sale of the property. On the other hand, a deed-in-lieu of foreclosure does not involve the sale of property. *See id.* § 203.357. Instead, it offers incentives to the borrower to transfer the deed to their property to the lender rather than face foreclosure proceedings. These incentives include avoidance of costs and litigation involved in foreclosures and a payment of up to five hundred dollars. U.S. DEP'T OF HOUS. AND URBAN DEV., MORTGAGE LETTER 96-61, FHA LOSS MITIGATION PROCEDURES-SPECIAL INSTRUCTIONS (1996), *available at* http://www.hudclips.org/sub_nonhud/html/shortcut.htm (follow "1996" hyperlink under Letters: Mortgage then locate letter 96-61).

96. 24 C.F.R. § 203.605.

97. CHANGES IN THE PERFORMANCE OF FHA-INSURED LOANS, *supra* note 17, at 28. The amount of incentives offered varies depending on the extent of the lender's participation in the loss mitigation program. Some incentives offered include higher reimbursements for foreclosure expenses, reimbursements for expenses incurred while mitigating losses, and cash payments. The amount of these payments depends on the type of mitigation strategy that was used most by the lender. ABT ASSOCIATES INC., AN ASSESSMENT OF FHA'S SINGLE-FAMILY MORTGAGE INSURANCE LOSS MITIGATION PROGRAM: FINAL REPORT 18-22 (2000), *available at* http://www.abtassoc.com/reports/20007197399621.pdf. On the other hand, lenders who do not comply with the procedures miss the opportunity to receive incentives and benefits and may face reduced reimbursement for foreclosure costs or lower interest rates when foreclosure is delayed. *Id.* at 10.

98. CHANGES IN THE PERFORMANCE OF FHA-INSURED LOANS, *supra* note 17, at 30.

99. *Id.* at 26.

100. *Id.*

many people as possible, so it will be difficult to balance its implementation with its previously established guidelines. The FHA must also focus on changes at the outset of its mortgages, which will reduce the need for these loss mitigation strategies and less risky borrowers in the future. Part III.C of this Note discusses some potential mitigation options for the FHA.

III. PROPOSALS TO REDUCE FORECLOSURE RATES

A. Policy Considerations

At the heart of the recent rise in foreclosures is the struggle between those who want increased homeownership opportunities for all and those who encourage a limit to such endeavors. The private mortgage market, along with programs like the FHA, has made it increasingly easy for people who would not otherwise qualify for mortgages in the past to receive financing. Proponents of increasing homeownership for all citizens may see these changes as a good thing, while others focus on the additional costs of foreclosures and burdens on local communities and the economy. The benefits and disadvantages of homeownership are thus central to the debate about where the line should be drawn as to what constitutes permissible financing from lenders. Policymakers can "facilitate availability of low-priced mortgage credit, or they can provide protections to home-owners who experience financial difficulties, but they cannot do both."[101]

1. Advantages of High Homeownership.—"Housing is a necessary of life."[102] Housing can take many different forms, from huge mansions owned by individuals to small apartments rented on a monthly basis. However, the "American dream" is to own some type of property, and therefore many believe that increasing homeownership can improve the morale of society. While studies cannot readily quantify and measure this positive emotional response, some studies have focused on peripheral advantages of owning a home.

First, homeowners have more of a financial interest and investment in their neighborhood and therefore are likely to be more conscientious about improving the quality of their surroundings than renters, who typically stay in one location for a short period of time. This conscientiousness can include taking better care of property or being more likely to vote for proposals needed for the future, such as road improvements.[103] Thus, the entire community benefits by having more homeowners in the area who take responsibility for managing and improving their investment.[104]

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101. PENCE, *supra* note 5, at 3.

102. Jonathan Douglas Witten, *The Cost of Developing Affordable Housing: At What Price?*, 30 B.C. ENVTL. AFF. L. REV. 509, 509 (2003) (quoting Block v. Hirsch, 256 U.S. 135, 156 (1920)) (emphasis omitted).

103. Peter Coy, *When Home Buying by the Poor Backfires: For Many Families, a House Can Be a Bad Investment*, BUS. WEEK, Nov. 1, 2004, at 68.

104. Daniel Aaronson, *A Note on the Benefits of Homeownership* 2 (Fed. Reserve Bank of

Aside from the external benefits homeownership may bring, there are individual benefits for the owner and their family. For example, the stability of owning a home, as opposed to short-term renting, can benefit children. Studies have shown that moving can have significant negative impacts on student achievement.[105] Also, homeowners can build equity and receive returns from their ownership investment in the form of appreciation, while renters instead make monthly payments to their landlords that are never recoupable. In addition to the stability that a home provides, this additional wealth from homeownership returns can provide better opportunities for children as well.[106]

In an ideal world, every citizen would have a home that they could afford and in which they could be comfortable. In this utopian society, people would take pride in their homes and the overall quality of the community would improve. However, the housing market is not perfect, and there are many problems that people create when they enter the housing market with inadequate means.

2. Disadvantages of High Homeownership.—Although the benefits of homeownership all have merit, they can be too idealistic in a society where foreclosure rates are on the rise. The theory of community improvement could become a reality, but there is also a substantial risk that increased homeownership will create more community harm than good. Because cities across the country have already been built-up and many low-cost homeownership options have moved to outlying areas, suburban sprawl has created real problems, both environmental and social.[107] Suburban housing areas may improve community surroundings in these areas, but it comes at the expense of the urban housing community, which is often left to the poor.[108] In the communities where new homeownership is thriving, unmanageably high homeownership rates may also have negative impacts because of the threat of foreclosure. Foreclosures, whether judicial or nonjudicial, have the effect of decreasing surrounding property values. In addition, foreclosures may lead to abandoned properties during the lengthy foreclosure process, causing deterioration in the structural and aesthetic quality in the area.

From an individual perspective, owners have been increasingly unable to build equity in their homes, and studies have shown that homeownership is not the most reliable means of building wealth for low-income families. Instead,

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Chi., Research Dep't, Working Papers Series, WP 99-23, 1999), *available at* http://www.chicagofed.org/publications/workingpapers/papers/wp99_23.pdf.

105. *Id.* at 3.

106. *Id.* at 8.

107. Michael Lewyn, *Suburban Sprawl: Not Just an Environmental Issue*, 84 MARQ. L. REV. 301, 301-03 (2000). Suburban sprawl is "the movement of people . . . and jobs from older urban cores to newer, less densely populated . . . communities generally referred to as suburbs." *Id.* at 301.

108. *Id.* at 305-12. Congress has expressed concern over these trends through the Housing and Community Development Act of 1974, 42 U.S.C. § 5301 (2000), which aims to encourage investment in housing for blighted urban neighborhoods. People's Hous. Dev. Corp. v. City of Poughkeepsie, 425 F. Supp. 482, 484 (S.D.N.Y. 1976).

other assets such as stocks tend to increase wealth more safely and effectively, even when appreciation for homes is at its peak.[109] This inability to build equity is also a result of owners borrowing against their equity to pay the bills that homeownership has created for them.[110] Furthermore, the tax advantages that homeownership can provide do not always benefit low-income families as much as established homeowners.[111]

Even in the utopia where homeowners are able to maintain equity in their homes, generate wealth, and contribute to the community, there are concerns that homeownership still may not be ideal. The increased time and money that is given to improving the community may actually be less helpful than any direct payoff that is made to a homeowner's family, including children.[112] While the increase in homeownership rates is commendable, it is possible that we have reached a point of diminishing returns where the addition of more owners will only cause more problems in foreclosure and the abandonment of more homes.

B. Changes to Indiana Foreclosure Laws

Foreclosure laws across the United States are fragmented. Although past proposals attempted to create uniform national foreclosure laws,[113] a system for which there are many proponents,[114] states remain free to make independent decisions in this area. While the continued pursuit of a universal system is noble, statutory reform by individual states is the immediate cure for increased foreclosure rates.

Because mortgage and foreclosure law is established on the state level, Indiana has additional onus to create laws amicable to the welfare of its citizens. Currently, Indiana's foreclosure laws are structured in a way that keep the state's foreclosure rates among the highest in the nation.[115] To remedy this problem, Indiana should adopt a nonjudicial foreclosure system in addition to its common

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109. Coy, *supra* note 103, at 68. In states like Indiana where there has been a massive amount of new housing being built and widespread foreclosures have decreased property values, appreciation rates are nearly non-existent and in some cases people have seen their investment value decrease.

110. Many first-time homeowners are not aware of the increased bills that accompany homeownership, such as property taxes and home insurance, as they are used to these expenses being covered by their landlord wherever they rented.

111. The Internal Revenue Code allows for tax deductions for interest paid, including the large amount of interest on mortgages, under 26 U.S.C. § 163(h)(2)(D) (2000).

112. Aaronson, *supra* note 104, at 3.

113. As early as 1973, the ninety-third United States Congress considered a resolution that would establish standard foreclosure procedures. Frank S. Alexander, *Federal Intervention in Real Estate Finance: Preemption and Federal Common Law*, 71 N.C. L. REV. 293, 316 (1993).

114. *See, e.g.*, Nelson, *supra* note 24, at 1399; Patrick A. Randolph, Jr., *The Future of American Real Estate Law: Uniform Foreclosure Laws and Uniform Land Security Interest Act*, 20 NOVA L. REV. 1109 (1996).

115. *See supra* note 2.

law judicial foreclosure process.

Nonjudicial foreclosures, which expedite foreclosure proceedings because of the decreased time and expense required for lenders, are actually more prevalent in states with low foreclosure rates. Based on a 2003 report by the National Association of Realtors, fifteen states had a foreclosure rate less than 0.9%; of those fifteen states, thirteen permitted nonjudicial foreclosure.[116] Perhaps more significantly, seven of the nine states that had foreclosure rates of 1.6% or higher required judicial foreclosure.[117] Only Mississippi and Utah employ a nonjudicial foreclosure process while suffering poor foreclosure rate performance, but their performance can largely be attributed to extraneous circumstances.[118]

Although somewhat counterintuitive, several factors support the correlation between judicial foreclosure and high foreclosure rates. First, although judicial foreclosure is intended to protect borrowers, lenders could be passing the higher costs of court proceedings to homeowners in the form of higher interest rates and larger fees.[119] These additional costs make it more difficult for borrowers to increase equity in their homes, which makes them more susceptible to default. Because of the extra costs that judicial foreclosure entails, lenders attempt to avoid foreclosure and pursue alternative methods once default occurs,[120] but at that point the borrower is likely insolvent and even concessions may not prevent foreclosure. On the other hand, nonjudicial foreclosures allow lenders to be more flexible and forbearing with borrowers at the outset of the mortgage.

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116. These states included Alaska, Arizona, California, Colorado, Hawaii, Massachusetts, Minnesota, Montana, New Hampshire, North Dakota, Rhode Island, South Dakota, Vermont, Virginia, and Wyoming. Only North Dakota and Vermont were judicial foreclosure states that maintained a low foreclosure rate. Rising Foreclosure Rates in Indiana, *supra* note 6, at 15-16.

117. The nine states with the highest foreclosure rates included Indiana, Kentucky, Louisiana, Mississippi, New Mexico, Ohio, Pennsylvania, South Carolina, and Utah. *Id.*

118. Utah's "unique local culture" augments its foreclosure rates. *Local Culture and National Economy Cause Utah Bankruptcies*, 15 CONSUMER BANKR. NEWS 5, Feb. 17, 2005. The state amplifies the impact of national economic problems, because its citizens marry at earlier ages, have larger families, and buy homes earlier than national averages. Recent layoffs and additional children have forced many Utah citizens to fall behind on their mortgage payments, especially where both spouses were working to afford their monthly payments. *Id.* Mississippi's problems are not as readily apparent. The state has recently discovered a dramatic increase in the occurrence of predatory lending, especially "flipping." Kevin Walters, *Mortgage Fraud Probe Expands into New Week*, HATTIESBURG AM., May 25, 2003, at 1A. Flipping occurs when a lender encourages the borrower to repeatedly refinance his or her original mortgage, which adds higher interest and fees that reduce any equity the borrower originally had in the property. Ferguson, *supra* note 11, at 607, 609. Although the threat of predatory lending has extended beyond Mississippi's borders, new occurrences of fraud may artificially spike the foreclosure rate of an otherwise stable state.

119. Pence, *supra* note 5, at 1. This study found that the most plausible factor connecting foreclosure law and foreclosure rates was whether the state is a judicial or nonjudicial foreclosure state. *Id.* at 3.

120. *Id.* at 5.

Second, the extensive time requirements for judicial foreclosures create additional problems for the housing market.[121] The delay caused by judicial foreclosure finalization increases the likelihood of abandonment and deterioration of the property in question, which can have adverse effects on the surrounding area.[122] Indiana has seen this problem firsthand. Based on 2003 census data, one of every thirty homes in Indianapolis is abandoned, more than any other midwestern city.[123] Although proposals have been made to deal with these abandoned homes,[124] the continued existence of exclusively judicial foreclosure laws will only exacerbate the problem.

Finally, Indiana should also become a nonjudicial foreclosure state because it will allow more time to adjust to the change than if a new federal government regulation requires the state to use only nonjudicial foreclosure. If a universal foreclosure program is instituted, it will likely take the form of nonjudicial foreclosure because of its time and cost advantages. Congress followed this logic in enacting the Multi-Family Mortgage Foreclosure Act and Single-Family Mortgage Foreclosure Act in 1981 and 1994, respectively.[125] The Acts require that all mortgages held by HUD, which includes all FHA loans, be foreclosed using nonjudicial foreclosure even if the state prohibits the action.[126] Due to the widespread use of FHA programs, the Acts have had the ability to exert significant influence. However, other problems with the FHA's policies have prevented the agency from having a positive effect on foreclosure rates.

Additionally, during the transition from judicial to nonjudicial foreclosure laws, Indiana should implement loss mitigation strategies similar to those used by the FHA. These agency programs have had significant initial success and

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121. The average judicial foreclosure process takes approximately one year to complete, whereas the average nonjudicial foreclosure lasts only four months. Nelson A. Diaz, *HUD's New Foreclosure Act Cutting Losses and Improving Business Management*, 75 MICH. B.J. 532, 533 (1996). Furthermore, as the number of foreclosures increases in these judicial foreclosure states, courts will become increasingly delayed in adjudicating them. This will further compound the problems that delay can have on property values and conditions.

122. *Id.* The existence of abandoned homes in an area can "stifle [the] values of surrounding homes, . . . increase crime and cripple economic development." John Fritze, *Abandoned Homes Still a Problem; City Might Come Down Harder on Owners; Neighbors Uneasy With Crime, the Homeless*, INDIANAPOLIS STAR, Oct. 15, 2004, at 1A.

123. Not surprisingly, the Department of Housing and Urban Development, whose large presence in Indiana has been previously addressed, owns the largest share of these abandoned homes. *Id.*

124. The city of Indianapolis proposed increased fines for owners of abandoned homes, pass-through taxation for any repair costs, and appointment of receivers to take control of the property and resell it once repairs were made. *Id.*

125. *See* Diaz, *supra* note 121, at 532. The Multi-Family Mortgage Foreclosure Act is codified under 12 U.S.C. §§ 3701-3717 (2000). The Single-Family Mortgage Foreclosure Act, which applies to mortgages for one to four families, is codified under 12 U.S.C. §§ 3751-3768 (2000).

126. Diaz, *supra* note 121, at 532.

Indiana could easily adopt them. The money that Indiana pays in the form of judicial foreclosure court costs and fails to collect in property taxes because of depressed property values could be better applied toward rewarding lenders who provide alternatives to borrowers who have defaulted. The state would likely not be able to require lenders to pursue these mitigation strategies like the FHA, but offering attractive incentives could begin adequate participation to warrant the introduction of such a mandatory program.

C. Proposed Changes to the FHA Program

Although the FHA has been in place for over seventy years, it still needs refinement. The most drastic change for the FHA would be its dissolution, an idea that has been considered in the past. "[M]any people (including many members of Congress) have questioned the usefulness of the FHA and suggest that its role would be better performed by the private sector," where financial markets are stronger and more sophisticated than they used to be.[127] Indeed, the strong competition of the private mortgage insurance market shows that it could be capable of providing inexpensive insurance for all borrowers. In addition to the numerous logistical difficulties of such a switch,[128] it is unlikely that the federal government will dissolve such a longstanding and historically significant agency. Therefore, the focus of changing the FHA should be on improving its practices.

1. Mandatory Mortgage Counseling.—The first, and perhaps most significant, change that the FHA should implement is requiring homeowner counseling for all first-time borrowers. The FHA's insureds are largely comprised of first-time borrowers unfamiliar with the mortgage process.[129] There are currently few government and local consumer-education programs and, due to industry opposition and cost concerns, they may be slow to expand.[130] Thus, it is even more essential that these FHA borrowers receive adequate information before undertaking such a monumental investment.

As of 2003, only three states required pre-foreclosure counseling: Georgia,

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127. Albert Monroe, *How the Federal Housing Administration Affects Homeownership* 4 (Harvard University Joint Center for Housing Studies, Working Paper W02-4, 2001), *available at* http://www.jchs.harvard.edu/publications/governmentprograms/monroe_w02-4.pdf.

128. If the FHA ever dissolved, a decision would have to be made whether the program would simply stop issuing insurance to any new borrowers or whether insurance would immediately cease for all borrowers. In the earlier case, it would likely take an excessive amount of time to fully divest the FHA of all its mortgages. However, it would be equally difficult to require borrowers to seek new mortgage insurance from private sources to maintain the lower interest rates they were likely receiving as a result of the insurance. Private insurers would have a large amount of leverage at that time and could offer unfavorable terms.

129. *See supra* note 80.

130. Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1309 (2002).

New York, and North Carolina.[131] The Department of Housing and Urban Development currently requires counseling for the elderly under the Home Equity Conversion Mortgage program.[132] HUD provides grants to self-sufficient, non-profit counseling agencies that undergo certification from the Department and provide services to these elderly mortgagors.[133] Furthermore, on September 10, 2004, the federal government announced a national campaign to educate consumers on the threat of predatory lending.[134]

While these programs have merit and are likely helpful to outline the various loss mitigation techniques available and tactics used by predatory lenders, the ideal time for counseling is at the outset of the mortgage. Even the best pre-foreclosure counseling may not be able to fix problems with a mortgage that are created at its inception. Many times, the key problem with a mortgage is that the mortgagor, unaware of the extra costs and hidden fees that a mortgage may contain, borrows too much money and is unable to make payments. Both HUD and the FHA have recently increased the limits for loan values that they insure,[135] and therefore they have a responsibility to educate borrowers about increased housing expenditures.

Despite the inherent costs of providing counseling for all first-time borrowers, the FHA is logistically and financially able to provide such a program. By broadening its certification process to include more independent agencies, HUD could adequately satisfy the number of borrowers needing counseling. This expansion is essential, because studies have shown that individual counseling is the most effective and beneficial counseling method for borrowers.[136] Furthermore, the FHA appears to be financially solvent enough to incur the expenses of such a program.[137]

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131. Harold L. Levine, *A Real Estate Focus: A Day in the Life of a Residential Mortgage Defendant*, 36 J. MARSHALL L. REV. 687, 700 (2003).

132. *Id.*

133. Donna S. Harkness, *Predatory Lending Prevention Project: Prescribing a Cure for the Home Equity Loss Ailing the Elderly*, 10 B.U. PUB. INT. L.J. 1, 41 (2000).

134. HUD Website, http://www.hud.gov/local/in/news/2004-09-10.cfm (last updated July 1, 2005). The program will start in twenty United States cities, including Indianapolis, where HUD has a high concentration of insured homes and knows predatory lending exists.

135. *See supra* note 86 and accompanying text.

136. Counseling can reduce mortgage delinquency, but different approaches have had varying success. For example, classroom and home study counseling had some benefit for borrowers, but telephone counseling had no effect on mortgage success. Abdighani Hirad & Peter M. Zorn, A Little Knowledge Is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling 2 (May 22, 2001), http://www.freddiemac.com/corporate/reports/pdf/homebuyers_study.pdf.

137. Even though the FHA has seen a large increase in the number of foreclosed properties that it insures, it has remained above its two percent insurance pool requirement for the MMIF during the same time period. Furthermore, the FHA could transfer some of the cost of the grants to the borrower through direct chargers or in the form of lower insurance premiums for borrowers who personally fund the counseling.

2. Varying Insurance Premiums.—Second, the FHA should vary its price of insurance according to a borrower's profile. As previously mentioned, the recent implementation of automated underwriting standards has enabled the FHA to identify borrowers who have a lower risk of default.[138] The FHA should leverage this technology to separate potential insureds into groups with varying insurance premiums. By rewarding borrowers who are a lower credit risk with reduced insurance premiums, the FHA will be able to more actively compete with the private mortgage insurance market. Under the current usage of the automated underwriting standards, the FHA is still losing quality insureds to the private market and the system's only purpose is to increase the speed with which lenders process the FHA loans.[139]

3. Change Loss Mitigation Incentive Structure.—Finally, the FHA should change the incentives and penalties for participation in its loss mitigation program. While the program has been a "powerful set of tools" for resolving mortgage delinquencies, it can and should make small changes to enhance the program's power.[140] In a 2000 study on the success of the loss mitigation program, the main recommendations for reform centered around more complete data collection and information sharing between lenders and HUD.[141] While these suggestions may have merit for HUD and the FHA in the future, its main concern should be ensuring continued involvement in the program. Under the loss mitigation program, the FHA provides incentives for program participation and penalties for lenders who do not participate.[142] While the FHA has, in the past, been able to impose these penalties against lenders without fear of recourse, they must now reevaluate the loss mitigation program's reward structure.

As stated previously, the private mortgage insurance market has created strong competition for the FHA. Lenders now have the option to encourage buyers to pursue either FHA or private insurance to obtain better interest rates. Because private mortgage insurers likely do not require loss mitigation before foreclosures and, even more likely, do not threaten penalties for non-compliance, many lenders may prefer to work with the private market. This will again flood the FHA's insurance portfolio with risky borrowers, because they will have fewer lenders with which to work. Thus, the FHA should focus on rewarding the lenders who use the loss mitigation system well with increased incentives and reduce or eliminate penalties for non-compliance. While this may increase the cost of the program, the FHA can likely afford the changes.[143] Furthermore, good relationships with lenders should reduce the risk of the FHA's insurance portfolio, leading to fewer foreclosures and less need for loss mitigation.

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138. CHANGES IN THE PERFORMANCE OF FHA-INSURED LOANS, *supra* note 17, at 26.

139. *Id.*

140. ABT ASSOCIATES INC., *supra* note 97, at 105.

141. *See id.* at 105-13.

142. *See supra* note 97.

143. *See supra* note 137.

CONCLUSION

No matter whether states use judicial or nonjudicial foreclosure, or whether a home is worth fifty thousand or five million dollars, problems with high foreclosure rates are pervasive in Indiana and across the nation. Although different states may attribute this trend to varying economic and social factors, the impact of each state's foreclosure procedures and of federal agencies such as the Federal Housing Administration cannot be ignored.

State foreclosure laws differ in many ways. States that are considered more lender-friendly allow for nonjudicial foreclosure, do not require notice of default or acceleration to the borrower, and do not create an additional statutory right of redemption. Meanwhile, borrower-friendly states require judicial foreclosure proceedings, mandate notice to mortgagors, and offer redemption rights beyond those given by common law. These small differences can greatly impact the number of foreclosures in a state.

The Federal Housing Administration, despite its longstanding tradition, has also contributed to poor mortgage performance. The FHA's insurance portfolio has grown increasingly risky because of the agency's goal to permit more homeowners. This has forced the agency to undertake several measures to strike a balance between homeownership for all and mitigating costs.

The gentle balance between reasonableness and promoting homeownership opportunities for all citizens is at the heart of foreclosure law. There are many undeniable personal and external benefits that owning a home can have on a community, but at some point these benefits are outweighed by the additional costs of pursing such a goal.

Indiana, just like every other state, must address and confront its foreclosure problems because the federal government has not implemented universal changes in foreclosure standards. However, by creating a statutory nonjudicial foreclosure scheme and pursuing loss mitigation strategies, Indiana should be able to remove its stigma as an unstable real estate market.

At the same time that states are reexamining their procedures, the FHA should continue to reduce its increasingly negative impact on the housing market. Although it is unlikely the entire agency will terminate, it can reduce its impact and own risk by creating counseling opportunities for unknowledgeable borrowers, rewarding borrowers with less risk, and encouraging lenders to do their part to reduce foreclosures.

While there is no quick fix to the highest national foreclosure rate in history, with concerted efforts from many parties, the American housing market can turn the corner and homeownership can become a dream for all once again.

CHILD ABUSE WITNESS PROTECTIONS CONFRONT *CRAWFORD V. WASHINGTON*

LAURIE E. MARTIN*

INTRODUCTION

The Sixth Amendment of the United States Constitution grants the accused in a criminal prosecution the right "to be confronted with the witnesses against him."[1] The right to confrontation of witnesses by a criminal defendant has long been at odds with the judicial system's desire to protect child witnesses in certain types of criminal prosecutions, such as sexual abuse proceedings. Because of the concern for child witnesses, courts have permitted special hearsay exceptions and various methods of shielding child witnesses from the trauma of testifying in the courtroom with the defendant present.[2] States have used courtroom closure, a special "child's courtroom," protective evidentiary rules and hearsay exceptions, delayed discovery statutes, elimination of the marital privilege in child sexual abuse cases, videotaping, closed-circuit television, and use of a screen in the courtroom to protect child witnesses.[3] However, many of these methods arguably violate the defendant's Sixth Amendment Confrontation Clause rights because the defendant is not in face-to-face contact with the witness or is unable to cross-examine a non-testifying declarant on a statement he made out of court.[4]

The Supreme Court has upheld certain protective procedures in the context of child sex abuse cases when these procedures were challenged under the Confrontation Clause.[5] However, the Supreme Court's decision in *Crawford v. Washington*[6] on March 8, 2004, creates new questions about the validity of many protective statutes and child hearsay exceptions under the Confrontation Clause.[7]

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1. U.S. CONST. amend. VI.

2. *See* Katherine W. Grearson, Note, *Proposed Uniform Child Witness Testimony Act: An Impermissible Abridgement of Criminal Defendants' Rights*, 45 B.C. L. REV. 467, 468 (2004).

3. ROBERT H. MNOOKIN & D. KELLY WEISBERG, CHILD, FAMILY, AND STATE 479, 485-89 (4th ed. 2000).

4. *See* Coy v. Iowa, 487 U.S. 1012, 1016 (1988) ("[T]he Confrontation Clause guarantees the defendant a face-to-face meeting with witnesses appearing before the trier of fact.").

5. *See* Maryland v. Craig, 497 U.S. 836, 857 (1990) (upholding statutory procedure allowing child witnesses in sexual abuse cases to testify by one-way closed circuit television); Idaho v. Wright, 497 U.S. 805, 826-27 (1990) (approving procedure under which the child declarant's statements could be admitted if witness was unavailable and statement bore indicia of reliability but finding statement at issue was not supported by particularized guarantees of trustworthiness).

6. 541 U.S. 36 (2004).

7. *Id.* at 68-69 (barring admission of testimonial, out-of-court statements unless the witness is unavailable and defendant had a prior opportunity to cross-examine).

Crawford established that testimonial, out-of-court statements by witnesses not appearing at trial are inadmissible unless the witness is unavailable to testify in court, and the defendant had a prior opportunity to cross-examine the witness.[8] The new standard changed precedent set nearly twenty-five years ago in *Ohio v. Roberts*.[9] This Note examines the constitutionality of state-created hearsay exceptions and in-court protective procedures in the face of the Supreme Court's recent decision in *Crawford*.

Crawford should not affect protection of child witnesses. First, in-court protective procedures, such as the use of closed-circuit television, remain untouched because *Crawford* only applies to out-of-court statements. Second, *Crawford* does not apply if the statement is nontestimonial. Many statements by children are likely to be considered nontestimonial, even when such statements might be testimonial in other contexts. Third, *Crawford* maintained that forfeiture by wrongdoing is a waiver of the defendant's confrontation clause rights. Particularly in the area of child abuse, the forfeiture exception is likely to be interpreted expansively. Fourth, policy and public pressure on the courts support the continued use of child hearsay exceptions and in-court protective procedures.

Part I of this Note discusses prior Supreme Court law regarding the conflict between the Confrontation Clause and hearsay exceptions generally, including an examination of the Court's decision in *Crawford*. Part II looks at Supreme Court decisions on Confrontation Clause challenges in the context of child sex abuse. Part III briefly examines the policy supporting both defendants' Confrontation Clause rights and protection of child witnesses in sexual abuse prosecutions, as well as the contradictory social science in this area. In Part IV, this Note concludes that *Crawford* should not be construed as a per se invalidation of child hearsay statutes and that, overall, *Crawford*'s impact on child abuse witness protections should be minimal, at most.

I. THE CONFRONTATION CLAUSE IN THE SUPREME COURT

A. Historical Analysis

The Supreme Court emphasized the importance of cross-examination in securing the defendant's constitutional right of confrontation very early in Confrontation Clause jurisprudence. The Supreme Court interpreted the Sixth Amendment Confrontation Clause in *Mattox v. United States*[10] in 1895. Even

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8. *Id.* at 53-54.

9. 448 U.S. 56, 74 (1980) (holding that evidence from a witness not giving live testimony at trial was admissible if it was necessary to use such evidence and the statements bore adequate indicia of reliability).

10. 156 U.S. 237 (1895). Clyde Mattox was convicted of murder, but the court granted him a new trial. By the time of the second trial, two witnesses from the first trial had died. The court admitted to the jury the court reporter's notes of the testimony of the two deceased witnesses from the prior trial. Mattox claimed that admitting the record of their testimony violated his right to

from this early date, the Court acknowledged the existence of exceptions to the right of confrontation based on public policy and necessity.[11]

The Court held that it did not violate Mattox's Confrontation Clause rights to submit to the jury a written record of prior testimony of two deceased witnesses.[12] Mattox's rights were preserved because he had previously been face-to-face with the witnesses and each witness had been subjected to "the ordeal of a cross-examination" during a prior trial.[13] The Court felt that the primary goal of the Confrontation Clause was to prevent depositions or ex parte affidavits from being used against a defendant in lieu of personal examination and cross-examination of the witness.[14] Cross-examination was significant to the Court because it allowed the accused to "test[] the recollection and sift[] the conscience" of a witness and to compel the witness to stand face-to-face with the jury so they can judge his demeanor and credibility.[15]

The *Mattox* Court stated that technical adherence to the letter of the Confrontation Clause would go further than necessary to protect the accused and further than public safety warranted.[16] It noted that the rule must occasionally give way to considerations of public policy and the necessities of the case.[17] The court cited dying declarations as an example of technical hearsay that has historically been considered competent testimony and admitted as evidence "simply from the necessities of the case, and to prevent a manifest failure of justice."[18]

The Supreme Court further developed the need for cross-examination under the Confrontation Clause in 1899 in *Kirby v. United States*.[19] The lower court allowed the prosecution to use records of an allegedly related trial as evidence that the property Kirby possessed was stolen property.[20] The Supreme Court held

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confrontation. *Id.* at 240.

11. *Id.* at 243.

12. *Id.* at 244.

13. *Id.*

14. *Id.* at 242.

15. *Id.* at 242-43. The *Mattox* Court stated that the witness should be face-to-face with the jury, rather than the accused. *Id.* The accused was entitled to use the tool of cross examination to probe the truth of a witness's testimony, but face-to-face confrontation was for the direct benefit of the ultimate fact-finder who would evaluate the credibility of the witness: the jury. *Id.*

16. *Id.*

17. *Id.* at 243.

18. *Id.* at 244. Dying declarations are allowed under the rationale that impending death removes any temptation of falsehood and enforces adherence to the truth as would an oath were the defendant present at trial.

19. 174 U.S. 47 (1899). Joseph Kirby was indicted for possession of stolen goods and money from a U.S. post office. Prior to his trial, three other men were tried and convicted for stealing the goods in question. The Court allowed the prosecution to admit records of part of the trial of the three convicted men to establish that the goods possessed by Kirby were indeed stolen. *Id.* at 48-50.

20. *Id.* at 54, 61.

that this act violated the Confrontation Clause and reversed Kirby's conviction.[21] The Court classified the Sixth Amendment right of confrontation as "one of the fundamental guaranties of life and liberty."[22] The Court stated that Kirby could not be convicted "except by witnesses who confront him at trial, upon whom he can look while being tried, whom he is entitled to cross-examine, and whose testimony he may impeach in every mode authorized . . . ."[23] The *Kirby* Court emphasized both confrontation in the form of visual contact between the accused and the witness and confrontation in the form of cross-examination as among the rights guaranteed by the Constitution.

The *Mattox* and *Kirby* opinions have been instrumental in shaping modern Confrontation Clause decisions.[24] These early opinions established the two primary elements of confrontation thought to protect the accused from false convictions in criminal prosecutions: face-to-face contact and cross-examination.[25] *Mattox* established, however, that from the inception of Confrontation Clause jurisprudence, exceptions to a literal reading of the clause were recognized as vital to securing justice.[26] This balancing of public interests with the rights of the accused continues to be a point of contention throughout modern Confrontation Clause cases, including *Crawford v. Washington*.[27]

B. Modern Analysis

In 1980, the Court established the modern test for admissibility of hearsay over a defendant's Confrontation Clause objections in *Ohio v. Roberts*.[28] The Court in *Roberts* stated that some hearsay was admissible under the Confrontation Clause, if "necessary," and if the statement bore sufficient indicia of reliability.[29] This test became the basis for many child witness protection statutes which emerged in the mid to late 1980s.[30] However, the *Roberts*

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21. *Id.* at 61.

22. *Id.* at 55.

23. *Id.*

24. *Mattox* is cited in *Crawford v. Washington*, 541 U.S. 36 (2004); *White v. Illinois*, 502 U.S. 346 (1992); *Maryland v. Craig*, 497 U.S. 836 (1990); *Idaho v. Wright*, 497 U.S. 805, (1990); *Coy v. Iowa*, 487 U.S. 1012 (1988); *Ohio v. Roberts*, 448 U.S. 56 (1980); and *California v. Green*, 399 U.S. 149 (1970). *Kirby* is cited in *Crawford*, *Craig*, *Coy*, and *Green*.

25. Grearson, *supra* note 2, at 473-74.

26. Mattox v. United States, 156 U.S. 237, 243 (1895).

27. *Crawford*, 541 U.S. at 67-68 ("By replacing categorical constitutional guarantees with open-ended balancing tests, we do violence to their design.").

28. *Roberts*, 448 U.S. at 56.

29. *Id.* at 65-66.

30. *See* Maryland v. Craig, 497 U.S. 836, 854-55 nn.2-4 (1990). When *Craig* was decided in 1990, thirty-seven states permitted videotaped testimony, twenty-four states permitted one-way closed circuit television testimony, and eight states permitted two-way closed circuit television procedures for child witnesses testifying in abuse cases. The states passed the statutes cited in *Craig* between 1984 and 1990, after the *Roberts* decision.

reliability test was recently overturned in favor of a new standard in *Crawford v. Washington*.[31] After *Crawford*, testimonial out-of-court statements by witnesses are barred under the Confrontation Clause unless the witness is unavailable and the defendant had prior opportunity to cross-examine the witness, regardless of any indicia of reliability that the statements may bear.[32]

1. Ohio v. Roberts.—Prior to *Crawford*, *Roberts* articulated the standard for introducing out-of-court statements from a witness who is not produced for live testimony at trial under the Confrontation Clause.[33] *Roberts* established that such evidence was constitutional if the circumstances showed that the witness was unavailable, in the constitutional sense,[34] to appear at trial, and if the hearsay testimony bore adequate indicia of reliability.[35] The Court stated that the primary interest secured by the Confrontation Clause was the right of cross-examination,[36] but continued to agree that competing interests "may warrant dispensing with confrontation at trial."[37]

Under *Roberts*, the Confrontation Clause restricted admissible hearsay in two ways. First, because of the Confrontation Clause's preference for face-to-face confrontation between the accused and the witness,[38] the prosecution had to show that it was necessary to use the declarant's statement because the declarant was

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31. *Crawford*, 541 U.S. at 53-54.

32. *Id.*

33. *Roberts*, 448 U.S. at 56.

34. The Court reiterated the "basic litmus of Sixth Amendment unavailability . . . : '[A] witness is not 'unavailable' for purposes of the . . . exception to the confrontation requirement unless the prosecutorial authorities have made a *good-faith effort* to obtain his presence at trial.'" *Id.* at 74 (quoting Barber v. Page, 390 U.S. 719, 724-25 (1968)). Whether the prosecution made a good-faith effort prior to trial to locate and present the witness is a question of reasonableness. *Id.* The *Roberts* Court held that the prosecution met their duty of good-faith effort in issuing five subpoenas at the last-known real address of the witness and holding a conversation with the witness's mother regarding her daughter's whereabouts. *Id.* at 76. However, Justice Brennan, joined by Justices Marshall and Stevens, dissented from the majority because he did not agree that the State met the "heavy burden . . . either to secure the presence of the witness or to demonstrate the impossibility of that endeavor." *Id.* at 78-79 (Brennan, J., dissenting).

35. *Id.* at 66 (majority opinion).

36. *Id.* at 63.

37. *Id.* at 64. One such interest pointed out by the Court is each jurisdiction's "strong interest in effective law enforcement, and in the development and precise formulation of the rules of evidence applicable in criminal proceedings." *Id.*

38. *Id.* at 65-66. The Court states that this preference for face-to-face confrontation and the right of cross-examination are both integral to the factfinding process. *Id.* at 63-64. However, the Court refers to a "preference" for face-to-face confrontation embodied in the Clause, in contrast to the clear "right" of cross-examination secured to the accused by the Clause, suggesting that cross-examination is more important than face-to-face contact between the accused and the witness. *Id.* This distinction is significant in the context of certain protective procedures such as allowing live testimony by a child witness via closed-circuit television, during which cross-examination may proceed unimpeded, but the defendant and the child are not actually in face-to-face contact.

unavailable to testify in person.[39] Second, once the witness was shown to be unavailable, the Confrontation Clause required that the statement bore sufficient indicia of reliability. This requirement was intended to further the Clause's purpose to "augment accuracy in the factfinding process."[40] Under the indicia of reliability test, reliability was inferred if the evidence fell within a firmly rooted hearsay exception.[41] If the evidence was not within a firmly rooted exception, it was excluded, absent a showing of "particularized guarantees of trustworthiness."[42]

2. Crawford v. Washington.—The Court's ruling in *Crawford* abrogated *Roberts*'s indicia of reliability test, at least as applied to testimonial statements.[43] *Crawford* also distinguished between "testimonial" and "nontestimonial"

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39. *Id.*; *see* Mancusi v. Stubbs, 408 U.S. 204 (1972); Barber v. Page, 390 U.S. 719 (1968); *see also* California v. Green, 399 U.S. 149, 161-62, 165, 167 n.16 (1970). However, the *Roberts* Court pointed out that a demonstration of unavailability was not required in *Dutton v. Evans*, 400 U.S. 74 (1970), when the Court determined that "the utility of trial confrontation [was] so remote that it did not require the prosecution to produce a seemingly available witness." *Roberts*, 448 U.S. at 65 n.7.

40. *Id.* at 65. The Court in *Roberts* said

> [t]he focus of the Court's concern has been to insure that there "are indicia of reliability which have been widely viewed as determinative of whether a statement may be placed before the jury though there is no confrontation of the declarant," and to "afford the trier of fact a satisfactory basis for evaluating the truth of the prior statement." It is clear from these statements, and from numerous prior decisions of this Court, that even though the witness be unavailable his prior testimony must bear some of the "indicia of reliability."

Id. at 65-66 (internal citations omitted) (quoting *Mancusi*, 408 U.S. at 213).

41. *Id.* at 66.

42. *Id.* The *Roberts* Court left it to the lower courts to determine what constituted a guarantee of trustworthiness. This situation led to unpredictability, and ultimately brought about *Roberts*'s demise in *Crawford*. *See* Crawford v. Washington, 541 U.S. 36, 62-65 (2004). Trial courts had great discretion in making determinations on the reliability and trustworthiness of statements, and rulings were unpredictable, contradictory, and often made without authority. *Id.*; *see* Sherrie Bourg Carter & Bruce M. Lyons, *The Potential Impact of* Crawford v. Washington *on Child Abuse, Elderly Abuse and Domestic Violence Litigation*, 28 CHAMPION 21, 22 (2004). *Crawford* cited examples where a statement was deemed reliable because it was "detailed," while another jurisdiction determined a statement was reliable because it was "fleeting." *Crawford*, 541 U.S. at 63. Statements were held to be reliable because they were obtained while a suspect was in custody and charged with a crime, and elsewhere held reliable because the witness was not in custody, and not a suspect in the crime. *Id.*

43. *Crawford*, 541 U.S. at 68. The Court states that "[w]here testimonial statements are at issue, the only indicium of reliability sufficient to satisfy constitutional demands is the one the Constitution actually prescribes: confrontation." *Id.* at 68-69. However, "[w]here nontestimonial hearsay is at issue, it is wholly consistent with the Framers' design to afford the States flexibility in their development of hearsay law—as does *Roberts*, and as would an approach that exempted such statements from Confrontation Clause scrutiny altogether." *Id.* at 68.

statements, a new development in Confrontation Clause jurisprudence.[44] Before looking at whether these changes will affect child hearsay exceptions and protective measures for child witnesses, a closer examination of the Court's decision is required.

In *Crawford*, the petitioner raised a Confrontation Clause challenge to the lower court's admission of his wife's tape-recorded statement to police during his assault trail.[45] Justice Scalia, writing for the majority, used historical and textual analysis, similar to the argument in his dissent in *Maryland v. Craig*[46] and Justice Thomas's concurrence in *White v. Illinois*,[47] to support two conclusions about the Clause: 1) The principal evil at which the Clause was directed was the civil-law use of ex parte examinations as evidence against the accused; and 2) The Framers of the Constitution would not have allowed admission of testimonial statements of a witness who did not appear at trial unless he was unavailable to testify, and the defendant had a prior opportunity for cross-examination.[48]

Unavailability of a witness and prior opportunity for cross-examination are not new Confrontation Clause requirements. The Court characterized these Confrontation Clause rights as procedural rather than substantive guarantees of reliability.[49] However, it was new to hold that these procedures are *the only means* sufficient to render a declarant's testimonial statement admissible if the declarant does not appear in court.

As mentioned above, the *Crawford* holding indicated that the Confrontation Clause may apply only to testimonial statements. The text of the Clause refers to "'witnesses against" a defendant. Because the term "witness" is defined as "those who bear testimony," the Court reasoned that the Clause applies only to testimonial statements.[50] After introducing this new distinction, the Court paradoxically left the task of devising a comprehensive definition of a

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44. *Id.*

45. *Id.* at 38. The wife did not testify at trial because the Washington state marital privilege bars one spouse from testifying without the other's consent, but the privilege does not extend to a spouse's out-of-court statements that fall under a hearsay exception. *Id.* at 40. The state argued that the statement fell under the hearsay exception for "statement[] against penal interest." *Id.* The Washington Supreme Court found that the statement did not fall under a firmly rooted hearsay exception, but did bear guarantees of trustworthiness because it "interlocked" with that of the defendant. *Id.* at 41.

46. 497 U.S. 836, 860-70 (1990) (Scalia, J., dissenting).

47. 502 U.S. 346, 365-66 (1992) (Thomas, J., concurring).

48. *Crawford*, 541 U.S. at 50-54.

49. *See id.* at 61. The Court stated that for testimonial statements, the Framers did not intend "to leave the Sixth Amendment's protection to the vagaries of the rules of evidence, much less to amorphous notions of 'reliability.'" *Id.* While acknowledging that exceptions to the common-law rule requiring cross-examination existed, such as that allowing admission of dying declarations, the Court pointed out that there was no general reliability exception. *Id.* at 61, 73.

50. *Id.* at 51.

"testimonial" statement for later decisions.[51] The Court stated that the term testimonial "applies at a minimum to prior testimony at a preliminary hearing, before a grand jury, or at a former trial; and to police interrogations."[52] Because even this loose definition included statements taken by police officers in the course of interrogations, Crawford's wife's statement to the police was testimonial. The Court concluded that admission of Crawford's wife's testimonial out-of-court statement violated the Confrontation Clause.

Although dissenting in overruling *Roberts*, Chief Justice Rehnquist, joined by Justice O'Connor, concurred in the *Crawford* judgment.[53] The Chief Justice stated that the distinction between testimonial and nontestimonial statements were no better rooted in history than the current precedent.[54] Statements given during police interrogations are not given under oath, and for this reason, such statements would likely have been disapproved of in the nineteenth century, but not because they resembled ex parte affidavits or depositions.[55] The concurrence criticized the Court for leaving the definition of testimonial unresolved, leaving thousands of federal and state prosecutors in the dark on how to apply the rules of criminal evidence.[56] Finally, the Chief Justice cited the rule from *Idaho v. Wright*,[57] that "an out-of-court statement was not admissible simply because the truthfulness of that statement was corroborated by other evidence at trial," as sufficient to exclude Crawford's wife's statement without overruling *Roberts*.[58]

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51. *See id.* at 68; *infra* note 173.

52. *Id.* The Court cited, without adopting, various definitions of testimonial statements including

> *ex parte* in-court testimony or its functional equivalent . . . material such as affidavits, custodial examinations, prior testimony that the defendant was unable to cross-examine, or similar pretrial statements that declarants would reasonably expect to be used prosecutorially, extrajudicial statements . . . contained in formalized testimonial materials, such as affidavits, depositions, prior testimony, or confessions, [and] statements that were made under circumstances which would lead an objective witness reasonably to believe that the statement would be available for use at a later trial.

Id. at 51-52 (internal citations omitted). The Court states that although not sworn testimony, "[s]tatements taken by police officers in the course of interrogations are . . . testimonial under even a narrow standard." *Id.* at 52.

53. *Id.* at 69-76 (Rehnquist, C.J., concurring).

54. *Id.* at 69.

55. *Id.* at 70. The oath is significant in the context of child witnesses because a child's competence and understanding of an oath is often at issue in child abuse trials. So-called "firmly-rooted" hearsay exceptions such as co-conspirator statements, spontaneous declarations, and statements made during medical examinations are not given under oath, but have still been historically admitted as evidence because "some out-of-court statements are just as reliable as cross-examined in-court testimony due to the circumstances under which they were made." *Id.* at 74.

56. *Id.* at 75-76.

57. *See infra* Part II.B.

58. *Crawford*, 541 U.S. at 76 (Rehnquist, C.J., concurring).

II. PROTECTION OF CHILD WITNESSES IN THE SUPREME COURT

The Supreme Court has examined several Confrontation Clause challenges to protective measures for child witnesses in child sexual abuse cases. These cases show an important distinction between in-court protective procedures used when the victim is testifying, such as "live" testimony displayed on a closed-circuit television, and evidentiary rules establishing prerequisites for admission of a child witness's out-of-court statements when the alleged victim is not able to testify in court. When in-court protective procedures are used, the child witness testifies but is physically shielded from the defendant in some manner. If the child cannot testify, hearsay exceptions allow the State to try to admit out-of-court statements by the child as evidence against the accused.

A. In-Court Procedures for Testifying Child Witnesses

1. Coy v. Iowa *(1988).—Coy v. Iowa* emphasized the importance of face-to-face confrontation with the defendant, and ultimately overturned the screening procedure utilized by the lower court because it denied the defendant a right to face-to-face confrontation.[59] The *Coy* Court reversed the appellant's conviction for two counts of lascivious acts with a child after a jury trial utilized a screening procedure.[60] A screen was placed between the appellant and the witness stand during the victim's testimony. When the lights in the courtroom were adjusted, the defendant could dimly perceive the witnesses, but the witnesses were not able to see the defendant at all.[61]

In the majority opinion, Justice Scalia reasoned that the Confrontation Clause guaranteed a face-to-face meeting with witnesses appearing before the trier of fact.[62] This "face-to-face presence may, unfortunately, upset the truthful rape victim or abused child; but by the same token it may confound and undo the false accuser, or reveal the child coached by a malevolent adult."[63] Iowa's statutory procedure was a violation of the Confrontation Clause because it contained a legislative presumption of trauma in all cases in which a child testified against an alleged sexual abuser.[64] Something more than this legislative presumption was required to trump the defendant's Confrontation Clause rights when the hearsay exception was not one "firmly . . . rooted in our jurisprudence."[65]

Although the majority opinion did not state whether any exceptions to the requirements of the Confrontation Clause existed,[66] Justice O'Connor's

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59. *See* Coy v. Iowa, 487 U.S. 1012, 1015-16, 1021 (1988).

60. *Id.* at 1022. Iowa Code § 910A.14 (1987) allowed use of a closed circuit TV or for the child witness to testify behind a screen. *Id.* at 1014.

61. *Id.* at 1014-15.

62. *Id.* at 1015-16.

63. *Id.* at 1020.

64. *Id.* at 1021.

65. *Id.* (quoting Bourjaily v. United States, 483 U.S. 171, 183 (1987)) (internal quotations omitted).

66. *Id.*

concurring opinion emphasized that a defendant's Confrontation Clause rights "may give way . . . to other competing interests so as to permit the use of certain procedural devices designed to shield a child witness from the trauma of courtroom testimony."[67] O'Connor reiterated that while a literal interpretation of the Confrontation Clause could bar use of any out-of-court statement when the declarant was unavailable to testify in court, the Court has consistently concluded that this result would be "unintended and too extreme."[68] O'Connor stated that protective procedures were permitted only when "necessary to further an important public policy."[69] She stated that a showing of necessity required a case-specific finding of trauma to the witness caused by face-to-face testimony.[70]

Justice Blackmun dissented because he felt that despite the screening procedure, the testimony at issue was given under adequate procedural safeguards to preserve the "purposes of confrontation."[71] Blackmun expressed concern that focus on face-to-face confrontation could lead states to sacrifice a more central Confrontation Clause interest, the right to cross-examine the witness in front of the trier of fact.[72] Since the testimony at issue bore sufficient indicia of reliability, he felt that no more specific finding of necessity should be required and that there was no Confrontation Clause violation.[73]

2. Maryland v. Craig *(1990).*—Justice O'Connor delivered the 5-4 majority of the Court in *Maryland v. Craig.*[74] The Court looked at a challenged protective procedure that allowed a judge to receive, by one-way closed circuit television, the testimony of a child witness alleged to be a victim of child abuse.[75] The

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67. *Id.* at 1022 (O'Connor, J., concurring).

68. *Id.* at 1024-25 (quoting Ohio v. Roberts, 448 U.S. 56, 63 (1980)).

69. *Id.* at 1025.

70. *Id.*

71. *Id.* at 1025-27 (Blackmun, J., dissenting). The testimony was given under oath, was subject to unrestricted cross-examination, the defendant could see and hear the witness, and the screening procedure still allowed the jury to evaluate the demeanor of the witness.

72. *See id.* at 1028.

73. *Id.* at 1033-34. Blackmun addressed another argument against use of shielding devices: that they are inherently prejudicial and may indicate to the jury that the defendant is likely guilty if the child requires such protection to testify. *Id.* at 1034. However, Blackmun stated that no prejudice should have arisen from this procedure because "unlike clothing the defendant in prison garb" the screen is not something generally associated with guilt; moreover, the court explicitly instructed the jury to "draw no inference of any kind from the presence of [the] screen." *Id.* at 1034-35.

74. Maryland v. Craig, 497 U.S. 836, 836-60 (1990). The victim, a six-year-old girl, attended a kindergarten and prekindergarten operated by the defendant Sandra Craig. Using a one-way closed-circuit television for the child's testimony, the trial court convicted the defendant on counts of child abuse, first and second degree sexual offenses, perverted sexual practice, assault, and battery. *Id.* at 840.

75. *Id.* at 841; *see also* MD. CODE ANN., CTS. & JUD. PROC. § 9-102 (1989). To invoke the procedure, the state had to show that the witness would suffer "serious emotional distress such that the child cannot reasonably communicate." *Craig*, 497 U.S. at 838. The child witness, prosecutor,

Court held that "so long as a trial court makes . . . a case-specific finding of necessity, the Confrontation Clause does not prohibit a State from using a one-way closed circuit television procedure for the receipt of testimony by a child witness in a child abuse case,"[76] but remanded to the Maryland Court of Appeals to determine whether the trial court made the requisite finding of necessity.[77]

Significantly, the Court agreed with the Maryland Court of Appeals that face-to-face confrontation was "not an absolute constitutional requirement."[78] The Court engaged in a balancing test between the state's interest in the physical and psychological well-being of the child abuse victim and the defendant's right to face his or her accusers in court and concluded that the state's interest could outweigh the defendant's rights.[79] *Craig* still required a showing of necessity before a defendant's rights were limited by a procedure that permitted a child witness to testify in the absence of face-to-face confrontation.[80] The finding of necessity had to be case-specific, and the trial court had to find that the trauma to the child witness arose not from the courtroom generally, but from the presence of the defendant during testimony.[81] Finally, the emotional distress suffered by the child had to be "more than *de minimis*, i.e., more than 'mere nervousness or excitement or some reluctance to testify.'"[82] The Court also required some indication of the reliability of the statement, although the Court did not cite specifically to *Roberts*'s "indicia of reliability" test.[83] The Court stated in conclusion that upon a case-specific finding of necessity, the Confrontation Clause did not prohibit procedures that ensured reliability of the evidence by subjecting it to "rigorous adversarial testing," which "preserve[d] the essence of effective confrontation."[84]

Justice Scalia, joined by Justices Brennan, Marshall, and Stevens,

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and defense counsel withdraw to a separate room where the child is examined and cross-examined. The proceedings are displayed to the judge, jury, and defendant in the courtroom on the closed-circuit TV. The defendant remains in electronic communication with defense counsel and objections are made and ruled on as if the witness were in the courtroom. *Id.* at 841-42.

76. *Craig*, 497 U.S. at 860.

77. *Id.*

78. *Id.* at 857.

79. *Id.* at 853.

80. *Id.* at 855.

81. *Id.* at 855-56.

82. *Id.* at 856 (quoting Wildermuth v. State, 530 A.2d 275, 289 (1987)). The Court did not decide what this minimum showing of emotional distress required because the Maryland statute required that the child suffer "serious emotional distress such that the child cannot reasonably communicate," which clearly met the constitutional standard. *Id.* (quoting MD. CODE ANN., CTS. & JUD. PROC. § 9-102(a)(1)(ii)).

83. *See id.* at 857. In *Craig*, reliability was established because the child testified under oath, was subject to full cross-examination, and was observed by the judge, jury, and defendant during the testimony.

84. *Id.*

dissented.[85] As well as expressing concern that the text of the Constitution was being subordinated "to currently favored public policy," the dissent disagreed with the Court's implication that the Confrontation Clause did not require face-to-face confrontation.[86]

The dissent struggled to reconcile the Court's necessity requirement with the "unavailability" requirements of previous Confrontation Clause cases.[87] Justice Scalia equated being "unavailable" only because the witness is *unable* to testify in the presence of the defendant with a refusal to testify and said that mere unwillingness to testify cannot be a valid excuse under the Confrontation Clause.[88] He stated that the very object of the Clause is "to place the witness under the sometimes hostile glare of the defendant."[89] Finally, the dissent stated that the Constitution does not allow the sort of interest-balancing that the Court used to overcome the defendant's confrontation rights.[90]

B. Prerequisites for Admitting Statements of Child Witnesses Not Testifying

1. Idaho v. Wright *(1990).*—The Court decided *Idaho v. Wright*[91] on the same day as *Maryland v. Craig*. The Court held that admission of hearsay statements made by a child declarant to her examining pediatrician violated the defendant's Confrontation Clause rights.[92] A child's mother and boyfriend were accused of sexually abusing the child and her sister, who were ages five and two at the time the charges were filed. When the older daughter came forward with allegations of abuse, the father reported the events to the police and took both daughters to the hospital. The younger daughter's statements to the doctor she saw during this hospital examination, a pediatrician with extensive experience in child abuse cases, were at issue in the case.[93] The trial court admitted the child's statements under Idaho Rule of Evidence 803(24),[94] a residual hearsay

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85. *Id.* at 860-70 (Scalia, J., dissenting).

86. *Id.* at 861.

87. *Id.* at 865-67 (citing Idaho v. Wright, 497 U.S. 805, 815 (1990); United States v. Inadi, 475 U.S. 387, 395 (1986); Ohio v. Roberts, 448 U.S. 56, 65 (1980); Barber v. Page, 390 U.S. 719 (1968)).

88. *Id.* at 866.

89. *Id.*

90. *Id.* at 870.

91. 497 U.S. 805 (1990).

92. *Id.* at 813.

93. *Id.* at 809.

94. IDAHO R. EVID. 803(24). Idaho's residual hearsay exception states that the following is not excluded by the hearsay rule, even if the declarant is available as a witness:

> A statement not specifically covered by any of the foregoing exceptions but having equivalent circumstantial guarantees of trustworthiness, if the court determines that (A) the statement is offered as evidence of a material fact; (B) the statement is more probative on the point for which it is offered than any other evidence which the proponent can procure through reasonable efforts; and (C) the general purposes of these

exception that allowed statements having sufficient circumstantial guarantees of trustworthiness to be used as evidence.[95]

Using *Roberts*, the Court determined whether the incriminating statements admissible under the Residual Hearsay Exception also met the requirements of the Confrontation Clause.[96] The Supreme Court assumed, without deciding, that the younger daughter was unavailable to testify.[97] Therefore, the primary issue before the Court was whether the State had established sufficient indicia of reliability for the girl's statement to the doctor to withstand scrutiny under the Clause.[98]

Idaho's Residual Hearsay Exception is not a "firmly rooted hearsay exception," so it did not automatically bear the reliability that established hearsay exceptions are afforded.[99] The Court held that particularized guarantees of trustworthiness should be shown from the totality of the circumstances surrounding the making of the statement.[100] The purpose of this requirement was

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rules and the interests of justice will best be served by admission of the statement into evidence.

95. *Wright*, 497 U.S. at 811-12.

96. *Id.* at 814. The Court recognized that hearsay rules and the Confrontation Clause are designed to protect similar values, but pointed out that the Court has been careful not to equate Confrontation Clause prohibitions with the general rule prohibiting the admission of hearsay. The Court explained that the Confrontation Clause is more far-reaching because it bars some evidence that might be admissible under a hearsay exception. *Id.* *Crawford* expands the gap between Confrontation Clause and evidentiary rules of hearsay, if not completely separating the two concepts. *Crawford* leaves nontestimonial hearsay regulation to the States, stating that "it is wholly consistent with the Framers' design to afford the States flexibility in their development of hearsay law—as does *Roberts*, and as would an approach that exempted such statements from Confrontation Clause scrutiny altogether." Crawford v. Washington, 541 U.S. 36, 68 (2004).

97. *Wright*, 497 U.S. at 816. The trial court had conducted a voir dire examination of the younger daughter, age three at the time of the trial, and found that she was "not capable of communicating to the jury." *Id.* at 809.

98. *Id.*

99. *Id.* at 817.

100. *Id.* at 819. The Court declined to hold that a showing of reliability required any specific procedural prerequisites, such as a record of the child's statements in some form. *Id.* at 818. Similarly, the Court stated that reliability is not necessarily established by evidence presented at trial that corroborates the statement. *Id.* at 819. For example, although medical evidence corroborated the child's allegations that sexual abuse occurred, it did not make her statements about the identity of the abuser any more reliable. *Id.* at 824. The Court cited factors identified by state and federal courts that "properly relate" to whether hearsay statements by a child witness in a sexual abuse case are reliable: spontaneity and consistent repetition, mental state of the declarant, use of terminology unexpected of a child of similar age, and lack of motive to fabricate. *Id.* at 821-22. Justice Kennedy, joined by the Chief Justice and Justices White and Blackmun, dissented from the majority opinion because he saw no constitutional reason to exclude corroborating evidence from the inquiry into the trustworthiness of a child's statements. *Id.* at 828 (Kennedy, J., dissenting). He stated that corroborating testimony and physical evidence is actually preferable because, unlike

to demonstrate that "the declarant's truthfulness is so clear from the surrounding circumstances that the test of cross-examination would be of marginal utility."[101] The State was unable to rebut the presumption of unreliability with an affirmative reason arising from the circumstances in which the statement was made.[102] Therefore, the Confrontation Clause required exclusion of the girl's statements.[103]

2. White v. Illinois *(1992).*—In *White v. Illinois*, the Supreme Court held that out-of-court statements of a child sexual assault victim could be admitted under the spontaneous declaration and medical examination exceptions to the hearsay rule.[104] The State did not have to produce the victim at trial, nor did the court have to find that the victim was unavailable for testimony.[105] The four-year-old victim made statements to her babysitter, mother, a police officer, doctor, and nurse regarding an alleged sexual assault. The State attempted to call the child to the stand twice, but she left without testifying both times because she "experienced emotional difficulty on being brought to the courtroom."[106] Over the defendant's objections, the court allowed her babysitter, mother, and the police officer to testify about the child's statements pursuant to the Illinois hearsay exception for spontaneous declarations. The court allowed the doctor and nurse to testify to the child's statements based on both the spontaneous declaration exception and the exception for statements made in the course of securing medical treatment.[107] The defendant was convicted, but appealed on Confrontation Clause grounds under *Roberts* because there was no finding of unavailability of the child witness. The Court denied the defendant's Confrontation Clause challenge and affirmed the conviction.[108] The Court held

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an examination of the narrow circumstances in which a statement was made, it "can be addressed by the defendant and assessed by the trial court in an objective and critical way." *Id.* at 834.

101. *Id.* at 820 (majority opinion).

102. *See id.* at 821.

103. *See id.*

104. White v. Illinois, 502 U.S. 346, 349 (1992).

105. *Id.*

106. *Id.* at 350.

107. *Id.* at 350-51. The Illinois spontaneous declaration hearsay exception applies to "[a] statement relating to a startling event or condition made while the declarant was under the stress of excitement caused by the event or condition." *Id.* at 351 n.1 (quoting People v. White, 555 N.E.2d 1241, 1246 (Ill. App. Ct. 1990)). The medical examination exception, 725 ILL. COMP. STAT. ANN. 5/115-13 (West 2005) (formerly ILL. REV. STAT. 1991, ch. 38, ¶ 115-13), states in relevant part that

> statements made by the victim to medical personnel for purposes of medical diagnosis or treatment including descriptions of the cause of symptom, pain or sensations, or the inception or general character of the cause or external source thereof insofar as reasonably pertinent to diagnosis or treatment shall be admitted as an exception to the hearsay rule.

Id.; *see also White*, 502 U.S. at 351 n.2.

108. *White*, 502 U.S. at 353, 358.

that *Inadi v. United States*[109] had limited *Roberts*.[110] After *Inadi*, if the challenged out-of-court statements were not made during a prior judicial proceeding, the prosecution was not required to show that the declarant was unavailable.[111] The Court concluded that neither *Roberts* nor *Inadi* provided any basis for excluding spontaneous declaration and medical examination evidence on Confrontation Clause grounds.[112]

The Court also stated that *Coy* and *Craig* examined only the in-court procedures constitutionally required to guarantee a defendant's confrontation rights once a child witness was actually testifying.[113] Therefore, the "necessity requirement" from those cases could not be imported into "the much different context of out-of-court declarations admitted under established exceptions to the hearsay rule."[114]

Justice Thomas, joined by Justice Scalia, concurred in part and in the judgment.[115] The concurrence relied on text and history, as does Scalia's majority opinion in *Crawford*, and began to draw the line between formalized testimonial materials and nontestimonial hearsay.[116] The dissent also foreshadowed *Crawford*'s separation of Confrontation Clause doctrine from the rules of evidence regulating hearsay.[117] Thomas stated that "[n]either the language of the Clause nor the historical evidence appears to support the notion that the Confrontation Clause was intended to constitutionalize the hearsay rule and its exceptions."[118]

III. COMPETING POLICY INTERESTS AND CONTRADICTORY SCIENCE

Justice Scalia's dissent in *Maryland v. Craig* summarized two competing

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109. 475 U.S. 387 (1986).

110. *White*, 502 U.S. at 353-54.

111. *Id.* The *Inadi* court rejected a Confrontation Clause objection as to admission of co-conspirator statements. *Id.* For co-conspirators, a requirement of unavailability is unlikely to benefit the defendant because the statements are admissible without such a finding under the hearsay exception. *Id.* Because of the irreplicable context in which the statements were originally made, it is unlikely that the live testimony of the witnesses would add to the trial's truth-determining process. *Id.* at 354.

112. *Id.* at 357. The Court stated that hearsay testimony of spontaneous declarations and statements made during a medical examination, and indeed all "firmly rooted" exceptions, are made in contexts that provide "substantial guarantees of their trustworthiness." *Id.* at 355 & n.8. In fact, such statements may lose evidentiary value if replaced by live testimony because the conditions that made the statement reliable in the first place cannot be replicated in the relative calm of the courtroom. *Id.*

113. *Id.* at 358.

114. *Id.*

115. *Id.*

116. *Id.* at 365 (Thomas, J., concurring).

117. *See id.* at 365-66.

118. *Id.* at 366.

interests in all criminal prosecutions: the State wants more convictions of guilty defendants, while the defense wants fewer convictions of innocent defendants.[119] These interests are heightened for both sides when the crime is as heinous as sexual abuse of a child.[120] Scalia acknowledges that neither interest is "unworthy."[121] Nor are these interests necessarily in direct conflict. Presumably, both sides want a just outcome—convictions of the guilty, but not the innocent. A defendant's right to confrontation and the State's desire to protect child witnesses in abuse cases are more directly in opposition in the Confrontation Clause debate. Even *Crawford* acknowledges that "[t]he law in its wisdom declares that the rights of the public shall not be wholly sacrificed in order that an incidental benefit may be preserved to the accused."[122] The question becomes how "incidental" is this confrontation benefit afforded to the accused, and how much of the public right can be sacrificed in its preservation? The conflict between protecting a child witness and preserving a defendant's constitutional right to confrontation is further complicated by the lack of consensus among social scientists about whether well-intentioned child witness protections actually benefit the child.

A. Defendant's Rights

In 1808, sixteen years after the Sixth Amendment was ratified, Chief Justice Marshall stated of the Confrontation Clause:

> I know of no principle in the preservation of which all are more concerned. I know none, by undermining which, life, liberty and property, might be more endangered. It is therefore incumbent on courts to be watchful of every inroad on a principle so truly important.[123]

Justice Scalia apparently agreed. Scalia felt that the Framers included the Confrontation Clause as a specific constitutional guarantee "to assure that none of the many policy interests from time to time pursued by statutory law could overcome a defendant's right to face his or her accusers in court."[124] In Scalia's eyes, statutes affording protection to child witnesses that infringe upon a defendant's right to confront that witness in court are precisely what the Confrontation Clause is intended to prevent.[125] He calls the Court's balancing of interests in *Craig* a "subordination of explicit constitutional text to currently

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119. Maryland v. Craig, 497 U.S. 836, 867-68 (Scalia, J., dissenting).

120. *See id.*

121. *Id.* at 867.

122. Crawford v. Washington, 541 U.S. 36, 75 (2004) (O'Connor, J., concurring in judgment only) (quoting Mattox v. United States, 156 U.S. 237, 243 (1895)).

123. *Id.* at 73 (quoting United States v. Burr, 25 F. Cas. 187, 193 (C.C. Va. 1807) (No. 14,694)).

124. *Craig*, 497 U.S. at 860-61 (Scalia, J., dissenting).

125. *See id.* at 861.

favored public policy."[126]

Scalia felt that the "'special' reasons that exist for suspending one of the usual guarantees of reliability in the case of children's testimony are perhaps matched by 'special' reasons for being particularly insistent upon it in the case of children's testimony."[127] Studies show that children are more suggestible than adults, unable to separate fantasy from reality, and perhaps unable to comprehend the gravity of the proceeding in which they participate.[128] Although there is contradictory evidence available, some would prefer to leave social science out of the debate entirely because it is susceptible to considerable bias.[129] Biased information can lead to "hasty and deceptively attractive remedies" for scientists as well as lawyers, judges, and legislators swayed by the emotionality of the issues.[130]

Some commentators feel that balancing the constitutional rights of the defendant against the psychological health of a witness is troublesome and expressed concern that the broad language of *Craig* "encourage[d] lower courts to uphold confrontation-restrictive procedures."[131] Advocates of this position maintain that reducing stress and anxiety, familiarizing the child witness with court personnel and procedures, and increasing support may improve a child's ability to participate competently as a witness, without jeopardizing the constitutional rights of the defendant.[132]

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126. *Id.*

127. *Id.* at 868.

128. *See id.* Scalia's dissent describes the Scott County investigations in 1983-84 in Jordan, Minnesota, in which child abuse allegations ballooned into allegations of multiple murders. Although twenty-four adults were charged with molesting thirty-seven children, prosecution resulted in only one guilty plea, two acquittals, and twenty-one voluntary dismissals against the alleged abusers. Highly questionable investigatory techniques were used with the children, including in some cases as many as fifty interviews with a child, suggesting answers based on what other children had said, and separation of the children from their parents for months. Some children were told by their foster parents that they would be reunited with their real parents if they admitted that the parents abused them. *But see* Jean Montoya, *On Truth and Shielding in Child Abuse Trials*, 43 HASTINGS L.J. 1259, 1283 (1992) (explaining that some scientists are critical of studies purporting to demonstrate suggestibility of children because the studies cannot replicate real life traumatic situations).

129. *See* Montoya, *supra* note 128, at 1288. Modern research suffers from a "lack of effort on the part of investigators to disconfirm their own hypotheses—in part because of their strong advocacy positions." *Id.* at 1288-89.

130. *Id.* at 1289.

131. Bryan H. Wildenthal, *The Right of Confrontation, Justice Scalia, and the Power and Limits of Textualism*, 48 WASH. & LEE L. REV. 1323, 1362 (1991) (quoting Comment, *The Supreme Court, 1989 Term: Leading Cases*, 104 HARV. L. REV. 129, 137 (1990) (suggesting that at least one state court has upheld confrontation-restrictive procedures under *Craig* in State v. Crandall, 477 A.2d 483 (1990))).

132. *See* Task Force on Child Witnesses, *The Child Witness in Criminal Cases*, 2002 A.B.A. CRIM. JUST. SEC. 5; Robert P. Mosteller, Crawford v. Washington*: Encouraging and Ensuring the*

Under the highly discretionary indicia of reliability test from *Roberts*, unpredictability and lack of consistency made many abuse cases difficult to defend because once the court deemed a witness unavailable and admitted the hearsay, there was no way to challenge it.[133] *Roberts*'s critics see *Crawford* as a confirmation that the Confrontation Clause is not worthless in such situations.[134]

B. Protection of Child Witnesses

The object of the Confrontation Clause "is to place the witness under the sometimes hostile glare of the defendant,"[135] commanding that reliability be assessed "by testing in the *crucible* of cross-examination,"[136] because such "adversarial testing 'beats and bolts out the Truth much better.'"[137] These descriptions alone make it clear why some feel inspired to protect an already-traumatized child from further harm in the courtroom. Protective procedures are motivated by concerns about mental and emotional trauma to the child related to giving testimony and the damage it may do to the truth-seeking function of the trial itself.[138] There are compelling examples of traumatic experiences in the courtroom to support this concern.[139]

Despite Justices Marshall and Scalia's objections, the Court has recognized from the inception of Confrontation Clause jurisprudence that some interests outweigh the defendant's right to confrontation.[140] The Court has gone so far as

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Confrontation of Witnesses, 39 U. RICH. L. REV. 511, 592 (2005) ("The hearsay exception has given prosecutors incentives to encourage children to appear and testify and to help them to do so by . . . making them comfortable in the courtroom and leading them through what happens during testimony.").

133. Carter & Lyons, *supra* note 42, at 22.

134. *See id.*

135. Maryland v. Craig, 497 U.S. 836, 866 (1990).

136. Crawford v. Washington, 541 U.S. 36, 61 (2004) (emphasis added).

137. *Id.* at 62 (quoting M. HALE, HISTORY AND ANALYSIS OF THE COMMON LAW OF ENGLAND 258 (1713)).

138. Wildenthal, *supra* note 131, at 1342.

139. *See id.* at 1364 n.220. Wildenthal refers to literature describing a seven-year-old girl's fear that trial delays would allow her abusive father to carry out threats to kill her mother, and describes a report by a ten-year-old boy that a grand juror was laughing as the boy described his rape by two men at a closed hearing where no family member or acquaintance of the witness was allowed to be present.

140. *See* Mattox v. United States, 156 U.S. 237, 243 (1895) ("A technical adherence to the letter of a constitutional provision may occasionally be carried further than is necessary to the just protection of the accused, and further than the safety of the public will warrant."); Coy v. Iowa, 487 U.S. 1012, 1022 (1988) (O'Connor, J., concurring) (discussing that a defendant's right to confrontation is not absolute "but rather may give way in an appropriate case to other competing interests so as to permit the use of certain procedural devices designed to shield a child witness from the trauma of courtroom testimony"); *Craig*, 497 U.S. at 853 ("[A] State's interest in the

to call "a state's interest in 'the protection of minor victims of sex crimes from further trauma and embarrassment' . . . a 'compelling one.'"[141]

Special hearsay exceptions were developed to deal with some of the unique difficulties children face in the legal system.[142] Often, the child, and perhaps the professionals who interview and treat them later, are the only witnesses to the alleged crime.[143] Victims may want to pursue charges initially, but recant or change their mind later due to fear, pressure to change their story, concern about a family member or friend getting in trouble, or because the initial allegations were false.[144] Child witness unavailability is frequent because of incompetency or emotional unavailability.[145] Even if the child is theoretically available to testify, undeveloped cognitive and language skills may prevent him or her from adequately communicating the details of the crime.[146] Corroborative physical evidence of abuse is generally scarce.[147]

Given these difficulties, out-of-court statements of a child are important to the prosecution—often such statements are the most compelling evidence that the crime occurred, since many children initially disclose abuse to parents, teachers, friends, or a doctor.[148] Out-of-court statements may be the only evidence of abuse if the prosecution is unable to find corroborative physical evidence.[149] Finally, out-of-court statements are seen by some as the only means by which the child can communicate to the court when the child is too traumatized to take the stand or an ineffective witness when he does.[150]

The *Craig* Court relied on social science evidence to conclude that shielding child witnesses may further truth-seeking better than physical confrontation.[151] Yet the degree of trauma that testifying can cause a child witness is disputed among social scientists. Indeed, some studies suggest that a child's ability to

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physical and psychological well-being of child abuse victims may be sufficiently important to outweigh, at least in some cases, a defendant's right to face his or her accusers in court.").

141. *Craig*, 497 U.S. at 852 (quoting Globe Newspaper Co. v. Superior Court of Norfolk County, 457 U.S. 569, 607 (1982)).

142. Carter & Lyons, *supra* note 42, at 22 (stating that many of the same difficulties are shared by elderly abuse victims and domestic violence victims).

143. *Id.* at 21.

144. *Id.*

145. *Id.*

146. Elizabeth J.M. Strobel, Note, *Play it Again, Counsel: The Admission of Videotaped Interviews in Prosecutions for Criminal Sexual Assault of a Child*, 30 LOY. U. CHI. L. J. 305, 322 (1999).

147. *Id.*

148. *Id.* at 323.

149. *Id.*

150. *Id.*

151. Maryland v. Craig, 497 U.S. 836, 857 (1990) (citing favorably Gail S. Goodman & Vicki S. Heleson, *Child Sexual Assault: Children's Memory and the Law*, 40 U. MIAMI L. REV. 181, 203-04 (1985)).

testify is diminished in a courtroom setting,[152] and that "child witness-defendant confrontations can have a substantial negative effect on the child's ability or willingness to be accurate."[153] On the opposite front, some feel that testifying could actually be beneficial to a child. Scholarly literature offers some support for the proposition that testifying at the trial could be cathartic and a coping strategy for a child that provides some sense of control or vindication.[154] Still others say that even if short term effects of testifying are negative on the child, both testifying and non-testifying child abuse victims show gradual improvement over time.[155]

IV. ANALYSIS

Crawford should not affect child hearsay exceptions. First, in-court protective procedures like the use of closed-circuit television should remain untouched because *Crawford* does not apply when the child testifies. Second, *Crawford* does not apply if the statement is nontestimonial, and many statements by children are likely to be considered nontestimonial, even when such statements might be testimonial in other contexts. Third, *Crawford* maintained that forfeiture by wrongdoing is a waiver of the defendant's Confrontation Clause rights, and particularly in the area of child abuse, this forfeiture exception is likely to be broadly interpreted so as to remove any Confrontation Clause obstacles to the admission of out-of-court statements of the victim. Fourth, policy and public pressure on the courts support an interpretation that allows continued use of child hearsay exceptions and in-court protective procedures.

A. Crawford *Does Not Apply When the Child Testifies*

In-court protective procedures like the use of closed-circuit television should remain untouched after *Crawford*. The new rule from *Crawford* does not apply if the declarant testifies and is therefore subject to cross-examination.[156] Because the child is testifying and subject to cross-examination, albeit by closed-circuit television or through another shielding method, *Crawford* should not limit any in-court procedure that would be upheld under *Craig*. Reluctantly, some think, the *Crawford* decision did not overturn *Maryland v. Craig*.[157] The rule from

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152. Montoya, *supra* note 128, at 1281.

153. *Id.* at 1292 (quoting Douglas J. Peters, *The Influence of Stress and Arousal on the Child Witness*, *in* THE SUGGESTIBILITY OF CHILDREN'S RECOLLECTIONS 60, 75 (John L. Dorris ed., 1991)). The study reaching this conclusion demonstrated that children gave a higher percentage of accurate responses when picking a "thief" out of a photo lineup than they did when trying to identify the same thief in a live lineup.

154. Wildenthal, *supra* note 131, at 1363-64 n.219; Task Force on Child Witnesses, *supra* note 132, at 4.

155. *See* Task Force on Child Witnesses, *supra* note 132, at 4.

156. Crawford v. Washington, 541 U.S. 36, 53-54 (2004).

157. *See* John F. Yetter, *Wrestling with* Crawford v. Washington *and the New Constitutional Law of Confrontation*, 78 FLA. B.J. 26, 29 (2004) (stating that *Craig* is less secure after *Crawford*,

Craig regarding the use of in-court protective procedures is still governing precedent.[158] Therefore, "the Confrontation Clause does not prohibit use of a procedure that, despite the absence of face-to-face confrontation, ensures the reliability of the evidence by subjecting it to rigorous adversarial testing and thereby preserves the essence of effective confrontation."[159]

Crawford actually seems to back away from the Court's previous emphasis on face-to-face contact between the defendant and the accuser.[160] The *Crawford* Court focuses on the Confrontation Clause's procedural guarantee that a statement's "reliability be assessed in a particular manner: by testing in the crucible of cross-examination."[161] Without the emphasis on face-to-face contact, many in-court procedures, such as the use of videotaped or broadcasted testimony become even less problematic. As long as the procedure in question allows for cross-examination of the testifying witness, it should not violate the defendant's right to confrontation, despite the lack of in-person or eye-to-eye contact between the accuser and the defendant.

Some commentary suggests that encouraging prosecutors to put children on the stand to testify, with proper preparation, could allow compliance with *Crawford* without causing prosecutions to suffer.[162] *Crawford* stated that "when the declarant appears for cross-examination at trial, the Confrontation Clause places no constraints at all on the use of his prior testimonial statements."[163] The Court previously articulated what it means to be "available for cross-examination" in *California v. Green*, and concluded that a witness is available despite memory loss about the event, or even failure to remember or subsequently recanting the prior statement itself.[164] When the rules from *Crawford* and *Green* are read together, it appears that even if the child is a poor witness on the stand, the child is considered "present to defend or explain" any prior testimonial statements unless the restrictions on cross-examination are truly

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but not overruled); Richard D. Friedman, *Adjusting to* Crawford*: High Court Decision Restores Confrontation Clause Protection*, 19 CRIM. JUST. 4, 8 (2004) ("[T]he rule of *Maryland v. Craig* is presumably preserved.") (internal citation omitted).

158. *See* Maryland v. Craig, 497 U.S. 836, 855-57 (1990) (holding that the Confrontation Clause does not bar a child witness in an abuse case from testifying via one-way closed-circuit television outside the defendant's physical presence upon a case-specific finding that the procedure is necessary to protect the welfare of the child from "more than *de minimis*" trauma caused by testifying in the defendant's presence).

159. *Id.* at 857.

160. *See* Coy v. Iowa, 487 U.S. 1012, 1019-20 (1988). *Coy* left open the possibility of exceptions to the requirement of face-to-face contact, which had previously been recognized in *Craig*, 497 U.S. at 843.

161. *Crawford*, 541 U.S. at 61.

162. Mosteller, *supra* note 132, at 595 (explaining the Court's rule in United States v. Owens, 484 U.S. 554 (1988)); *see also* Yetter, *supra* note 157, at 32 (suggesting that the final impact of *Crawford* might be slight because compliance with the rules may be feasible).

163. *Crawford*, 541 U.S. at 59 n.9 (citing California v. Green, 399 U.S. 149, 162 (1970)).

164. Mosteller, *supra* note 132, at 586.

significant.[165] Therefore, if the child is testifying in even a minimal capacity, the prosecution can then presumably admit any prior out-of-court statements without raising a Confrontation Clause issue.

Crawford does not add to or change the Court's definition of unavailability, generally, for trial.[166] The issue of availability, both for cross-examination and for trial, leads to questions about the level of competency required for a child to be considered a witness. Neither *Crawford* nor any prior Supreme Court case adopts a constitutional concept of minimal competency, or clarifies whether confrontation with an incompetent witness is adequate under the Constitution.[167] In *Wright*, the Court refused to adopt a rule that the out-of-court statements of a child were "*per se* unreliable" because the trial court found the child witness incompetent to testify at trial.[168] Post-*Crawford* commentary suggests that the standard for competency of a child witness should be relatively low, or at least flexible.[169] The ability to take an oath in a technical sense should not be

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165. Allie Phillips, *A Flurry of Court Interpretations: Weathering the Storm After* Crawford v. Washington, 38 PROSECUTOR 37, 40 (2004); Mosteller, *supra* note 132, at 594-95 (citing Bugh v. Mitchell, 329 F.3d 496, 505 (6th Cir. 2003) (finding that the child witness was adequately available although only responding verbally to questions about one act of abuse and then nodding or shrugging only, which the court interpreted as memory failure)). *But see* Mosteller, *supra* note 132, at 587 (refusing to answer questions makes a witness unavailable). Scalia's dissent in *Craig* equated being unable to testify in the defendant's presence with a refusal to testify. *Craig*, 497 U.S. at 866 (Scalia, J., dissenting). However, the Court's prior interpretation of when "refusal" to testify rendered the witness unavailable under the Confrontation Clause involved a witness invoking Fifth Amendment privilege in response to all questions about the alleged crime. Mosteller, *supra* note 132, at 587-88. If a child actually appears on the stand and is capable of responding to any questions, even to say that they do not remember, the child is likely "available" for cross-examination. *See id.* at 594-96.

166. Friedman, *supra* note 157, at 8; *see* Ohio v. Roberts, 448 U.S. 56, 74 (1980) (describing constitutional unavailability); *see also supra* note 36 and accompanying text.

167. Mosteller, *supra* note 132, at 597. The issue of competency is significant when looking at Indiana's Protected Persons Statute, IND. CODE § 35-37-4-6 (e)(2)(b) (amended by 2005 Ind. Legis. Serv. P.L. 2-2005 H.E.A. 1398 (West) (technical corrections)), which allows a witness to be found unavailable if the court determines that "the protected person is incapable of understanding the nature and obligation of an oath." This appears to allow incompetence as a prerequisite for admission of the out-of-court statement of a protected person. *But see infra* notes 168-72 and accompanying text (exploring the difference between competency and the technical requirement of an oath).

168. Idaho v. Wright, 497 U.S. 805, 824 (1990). Idaho allows a child to testify if she is "[capable] of receiving just impressions of the facts . . . [and] of relating them truly." *Id.* (quoting IDAHO CODE § 9-202 (Supp. 1989); IDAHO R. EVID. 601(a)).

169. *See* Mosteller, *supra* note 132, at 599 (suggesting that legislatures should revise the rules of evidence and courts should interpret competency requirements more flexibly to allow for testimony and cross-examination of child witnesses); Friedman, *supra* note 157, at 10 (suggesting that a child should understand that his statement could lead to adverse consequences for the person accused, but that he needs no real understanding of the legal system before he may be considered

required.[170] The advisory committee's note to Federal Rule of Evidence 603 acknowledges the need for flexibility in the oath requirement for child witnesses,[171] and several courts have established competency rules that eliminate the oath requirement explicitly or indirectly for child witnesses in abuse cases.[172]

In conclusion, *Crawford* should have no effect on in-court protective procedures because the witness is testifying, and therefore subject to cross-examination. Courts should maintain flexible standards for competency and availability for cross-examination to allow child abuse witnesses to fully take advantage of this exception created by the *Crawford* Court.

B. Crawford *Does Not Apply to Nontestimonial Hearsay*

Crawford does not apply if the statement is nontestimonial. The *Crawford* Court "[left] for another day any effort to spell out a comprehensive definition of 'testimonial,'" saying that the term "applies at a minimum to prior testimony at a preliminary hearing, before a grand jury, or at a former trial; and to police interrogations."[173] Lower courts should apply the Court's "minimum" definition, at least until the Supreme Court provides more guidance.[174] This narrow definition means many child abuse victims' out-of-court statements will be found nontestimonial. Yet even under more expansive interpretations of the term

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a witness).

170. Mosteller, *supra* note 132, at 598.

171. FED. R. EVID. 603 advisory committee's note; Mosteller, *supra* note 132, at 598.

172. Mosteller, *supra* note 132, at 598 n.480.

173. Crawford v. Washington, 541 U.S. 36, 68 (2004). The Supreme Court may be ready to begin clarifying the definition of testimonial statements. The Court granted certiorari to review two state court decisions applying *Crawford*. Hammon v. State, 829 N.E.2d 444 (Ind. 2005), *cert. granted*, 74 U.S.L.W. 3265 (U.S. Ind. Oct. 31, 2005) (No. 05-5705); State v. Davis, 111 P.3d 844 (Wash. 2005), *cert. granted*, 74 U.S.L.W. 3272 (U.S. Wash. Oct. 31, 2005) (No. 05-5224). Both are domestic abuse cases. In *Hammon*, the Indiana Supreme Court determined that an oral statement by a domestic violence victim to police who arrived on the scene, admitted as an excited utterance, did not violate the Confrontation Clause, but admission of an affidavit made at the scene did violate the Confrontation Clause. *Hammon*, 829 N.E.2d at 458. The Indiana Supreme Court held that "statements to investigating officers in response to general initial inquiries are nontestimonial but statements made for purposes of preserving the accounts of potential witnesses are testimonial." *Id.* at 446. The court concluded that "generally . . . testimonial statements are those where a principal motive of either the person making the statement or the person or organization receiving it is to preserve it for future use in legal proceedings." *Id.* In *Davis*, the Washington Supreme Court examined whether admission of an emergency 911 call is barred under the Confrontation Clause and decided that 911 calls should be evaluated on a case-by-case basis because they could contain both nontestimonial and testimonial statements. *Davis*, 111 P.3d at 851. Statements made while "seeking assistance and protection from peril" were nontestimonial and properly admitted. *Id.*

174. *See infra* note 198 and accompanying text (describing post-*Crawford* interpretations of the term testimonial by lower courts).

"testimonial," many statements by young children are likely to be considered nontestimonial, even when they might be testimonial if made by an adult or older child.

Crawford listed, without adopting, three possible interpretations of the types of statements that could be considered testimonial and, therefore, inadmissible without confrontation: "*[E]x parte* in-court testimony or its functional equivalent," "extrajudicial statements . . . contained in formalized testimonial materials," and "statements . . . which would lead an objective witness reasonably to believe that the statement would be available for use at a later trial."[175] The first of these definitions would require the Court to identify "statements elicited by state agents in contexts analogous to ex parte judicial proceedings, the target evil of the framers."[176] These are formal, procedural events conducted for the purpose of obtaining testimonial evidence for later use and are discernable without reference to the intentions of the participants.[177] The second definition, perhaps because of its similarity to the first, has not received much individual attention.[178] *Crawford* elaborates that "formalized testimonial materials" include "affidavits, depositions, prior testimony, or confessions."[179]

The third possible definition, that the statement must be made in contemplation of future evidentiary use, is arguably the most expansive because it is not limited to statements made to a government official.[180] This definition itself can be viewed in multiple ways and may require a different conception of statements by children than statements by adults.[181] Using the hypothetical of a young child talking to his mother, there are four different ways to view the statements by the child. The child could have no comprehension of future evidentiary use of his statement, and it would then be considered nontestimonial.[182] A second view is that the child has some concept that telling his mother will get the person he is accusing in trouble, and that this is sufficient comprehension of future evidentiary use to render the child's statement to his mother testimonial.[183] A third view is that regardless of the age of the declarant, the perspective of an "objective observer" should determine whether future evidentiary use should have been contemplated.[184] This formulation is supported

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175. *Crawford*, 541 U.S. at 51-52.

176. Yetter, *supra* note 157, at 28.

177. *Id.* Yetter suggests that the interviewing of complainants of sexual abuse by members of child protection units is likely to produce testimonial statements under this definition. *But see* Phillips, *supra* note 165, at 38-40 (suggesting that forensic interviews should not be testimonial because they are conducted for the benefit of the child and not primarily for the purpose of criminal prosecution).

178. *See Crawford*, 541 U.S. at 51-52.

179. *Id.*

180. *See* Friedman, *supra* note 157, at 9.

181. *Id.* at 10-11.

182. *Id.* at 11.

183. *Id.*

184. *Id.*

by the language of *Crawford*, which refers to an "objective witness."[185] The question remains, should this observer be an objective child, or an objective adult? One post-*Crawford* court chose the perspective of an objective adult.[186] It applied an "objective observer" standard, as opposed to a proposed "objective witness in the same category of persons as the actual witness."[187] Finally, it is possible that the court could consider whether the hypothetical mother, or the person receiving the statement, contemplates future evidentiary use.[188]

Commentary suggests that courts are unlikely to adopt the third and most expansive approach suggesting that contemplated evidentiary use renders a statement testimonial.[189] It is criticized as unpredictable, unsupported by the historic view that Justice Scalia favors in the *Crawford* majority opinion, and under-inclusive of some categories of testimonial statements.[190] Furthermore, the Court actually used a different method to decide *Crawford*, so the "contemplated later evidentiary use" formulation is unsupported by Supreme Court precedent.[191]

Ironically, child protection advocates may be conflicted about opposing the adoption of the contemplated evidentiary use formulation because it leaves open the possibility that many potentially testimonial statements by children could avoid classification as testimonial.[192] This formulation's potential to allow children's statements that would not be allowed if they were made by adults is one reason the definition is labeled under-inclusive by critics.[193] Consequently, in some jurisdictions, adoption of this definition could actually be less restrictive on the use of children's out-of-court statements when the child is unavailable to testify.

Because the Court refrained from adopting any of the above formulations, the "safest" route for lower courts applying *Crawford* is to use the Court's "minimum" definition, including only prior testimony at a preliminary hearing, before a grand jury, or at a former trial, and police interrogations. This definition is the most restrictive and most likely to render a child's out-of-court statement nontestimonial.

One interesting element of the *Crawford* decision indicates that under any definition of testimonial statements, children's statements may be treated differently than those of adults in the same context. The Court left *White v.*

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185. *See* Crawford v. Washington, 541 U.S. 36, 52 (2004).

186. People v. Sisavath, 13 Cal. Rptr. 3d 753, 757-58 (Ct. App. 2004).

187. *Id.*

188. Snowden v. State, 846 A.2d 36, 47 (Md. Ct. Spec. App. 2004) (stating that the children's statements were testimonial because the social worker interviewed them "for the expressed purpose of developing their testimony"); *see* Mosteller, *supra* note 132, at 538; Phillips, *supra* note 165, at 40.

189. Yetter, *supra* note 157, at 29.

190. *Id.*

191. *Id.*

192. *Id.*

193. *Id.*

Illinois as good precedent.[194] In *White*, the Court held that a child's statements to a police officer made forty-five minutes after the abuse occurred, admitted under the spontaneous declaration hearsay exception, did not violate the defendant's confrontation rights.[195] If the *Crawford* Court considered this statement by the child victim to an investigating police officer testimonial, then *White* should have been overruled, because its admission violated the defendant's confrontation rights.[196] Because the Court did not overrule *White*, this implies either that it did not consider the child's statement testimonial, despite its classification as a statement taken during a police interrogation, or that this type of testimonial statement is an exception to the new rule.[197]

In conclusion, courts should use a narrow definition of testimonial, such as the "minimum" definition, until the Court offers more guidance.[198] Within this minimum definition, the term "interrogations" can also be construed narrowly, allowing many "informal" statements to police officers by child witnesses to be deemed nontestimonial.[199] According to one commentator, "if the testimonial

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194. *See* Crawford v. Washington, 541 U.S. 36, 58 n.8 (2004) (describing *White* as "one case arguably in tension with the rule" in *Crawford*); *id.* at 61 ("Although our analysis in this case casts doubt on [*White*'s] holding, we need not definitively resolve whether it survives our decision today . . . ."); *see also* Yetter, *supra* note 157, at 29 n.27 (citing *Crawford*'s refusal to overrule *White* as support for his view that the *Crawford* Court did not consider a child's statement to a police officer forty-five minutes after the alleged abuse "testimonial").

195. White v. Illinois, 502 U.S. 346, 357 (1992). The *Crawford* Court does not refer to the child's statements to her babysitter, mother, and medical personnel, and only mentions the child's statement to the police officer, perhaps because this statement is most directly implicated by the Court's conclusion that "[s]tatements taken by police officers in the course of interrogations are . . . testimonial under even a narrow standard." *Crawford*, 541 U.S. at 52.

196. Yetter, *supra* note 157, at 29 n.27.

197. *See Crawford*, 541 U.S. at 61. Another testimonial statement that may be an exception to the *Crawford* standard is testimonial dying declarations, which were historically admitted under the Confrontation Clause. *Id.* at 56 n.6 ("If this exception must be accepted on historical grounds, it is *sui generis*."). *But see* Yetter, *supra* note 157, at 29 n.27 (suggesting that the testimonial dying declaration exception is better explained by the doctrine of forfeiture by wrongdoing, under which the defendant waives his Confrontation Clause rights).

198. *See* Ramirez v. Dretke, 398 F.3d 691, 695 (5th Cir. 2005) (finding spontaneous out-of-court statements made outside a judicial or investigatory context nontestimonial under *Crawford*'s "minimum" definition); Leavitt v. Arave, 383 F.3d 809 (9th Cir. 2004) (finding that declarant's statements to police in her home were not testimonial statements under *Crawford*); United States v. Lopez, 380 F.3d 538 (1st Cir. 2004) (finding that defendant's statements at police station were not testimonial and therefore not subject to *Crawford* principles); Evans v. Luebbers, 371 F.3d 438 (8th Cir. 2004) (relying on narrow definition of testimonial statements as including only prior testimony at a preliminary hearing, before a grand jury, or at a former trial, and to police interrogations); United States v. Reyes, 362 F.3d 536 (8th Cir. 2004) (finding co-conspirator statements non-testimonial and therefore not subject to *Crawford* principles).

199. *Crawford* uses the term "'interrogation' in its colloquial, rather than any technical legal sense." *Crawford*, 541 U.S. at 53 n.4 ("Just as various definitions of 'testimonial' exist, one can

statement category is limited, the *Crawford* regime might be no less favorable to the admissibility of hearsay than the displaced 'reliability' structure of *Roberts*."[200] Between this narrow definition and evidence that statements by child abuse victims may be treated differently under any definition, many children's statements are likely to be excluded from *Crawford*'s requirements as nontestimonial. This supports the position that *Crawford* should not pose much threat to child witness protections.

For nontestimonial statements, it is clear that *Crawford* has no impact, but it is unclear whether nontestimonial statements still have any Confrontation Clause implications. *Crawford* leaves two possibilities: Either the nontestimonial statements are still subject to the *Roberts* reliability analysis, or they are completely outside the reach of the Confrontation Clause.[201] If nontestimonial hearsay is outside the reach of the Confrontation Clause, then state rules of evidence and hearsay law govern what is admissible.[202] This option removes any Confrontation Clause barrier to the admission of out-of-court statements of child witnesses that even *Roberts* may have posed.[203] If nontestimonial statements still have Confrontation Clause implications, then the Court indicated that *Roberts* may still be the operative test.[204] In the recent aftermath of *Crawford*, and presumably until the Court clarifies whether *Roberts* remains as a secondary form of constitutional protection for the accused, many lower courts will avoid the risk of reversal and apply the *Roberts* reliability analysis to nontestimonial hearsay.[205] The application of *Roberts* is good news for most child hearsay exceptions, which were drafted to comply with *Roberts*'s reliability analysis, and have subsequently withstood challenges to their facial constitutionality.[206]

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imagine various definitions of 'interrogation,' and we need not select among them in this case."). The Court leaves the selection of a definition of interrogation open, but states that the recorded statement at issue in *Crawford*, knowingly given in response to structured police questioning, "qualifies under any conceivable definition." *Id.*; *see also White*, 502 U.S. at 357; *Leavitt*, 383 F.3d at 830 n.22; *supra* note 195 and accompanying text.

200. Yetter, *supra* note 157, at 32.

201. *Crawford*, 541 U.S. at 68.

202. *Id.* The Court left the possibility of an "approach that exempted such statements from Confrontation Clause scrutiny altogether."

203. The evidence in question would still be subject to objection based on the requirements of state hearsay law, but at least would not raise the possibility of Confrontation Clause objections.

204. *Id.* "Where nontestimonial hearsay is at issue, it is wholly consistent with the Framer's design to afford the States flexibility in their development of hearsay law—as does *Roberts* . . . ."

205. *See* Mosteller, *supra* note 132, at 13 (citing State v. Rivera, 844 A.2d 191 (Conn. 2004) and People v. Coker, No. 238738, 2004 WL 626855 (Mich. Ct. App. Mar. 30, 2004)). The author suggests that a court can always, if it wants to, find the *Roberts* analysis satisfied and admit the evidence in question.

206. *See* Task Force on Child Witnesses, *supra* note 132, at 42.

C. Crawford *Does Not Apply if a Defendant Waives His Confrontation Rights by Forfeiture*

Crawford maintained that forfeiture by wrongdoing is a waiver of the defendant's Confrontation Clause rights.[207] Courts should interpret this exception in a way that allows prosecutors of child sexual abuse to show that the abuse itself prevented the victim/witness from testifying.[208]

Crawford states that "the rule of forfeiture by wrongdoing (which we accept) extinguishes confrontation claims on essentially equitable grounds . . . ."[209] The doctrine of forfeiture is based on the idea that a defendant should not profit from his own bad acts.[210] The principle is explained in *Reynolds v. United States*:

> The Constitution gives the accused the right to a trial at which he should be confronted with the witnesses against him; but if a witness is absent by his own wrongful procurement, he cannot complain if competent evidence is admitted to supply the place of that which he has kept away. The Constitution does not guarantee an accused person against the legitimate consequences of his own wrongful acts. It grants him the privilege of being confronted with the witnesses against him; but if he voluntarily keeps the witnesses away, he cannot insist on his privilege.[211]

If the prosecution can make an individualized showing that the defendant procured the child witness's absence in an abuse case, *Crawford* does not bar the admission of any out-of-court statements of the victim, testimonial or not, because the procurement constitutes a waiver of the defendant's Confrontation Clause rights.[212]

Forfeiture's application in child abuse cases raises more difficult issues than a scenario in which a defendant hires someone to murder the key witness against him shortly before he is scheduled to testify. In child abuse cases, the argument is that acts committed during the crime itself led to the victim's unavailability to testify.[213] Under this theory, guilt, embarrassment, or fear are caused during the abuse and ultimately render the child unable to testify.

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207. *Crawford*, 541 U.S. at 62.

208. *See* Friedman, *supra* note 157, at 12.

209. *Crawford*, 541 U.S. at 62 (citing Reynolds v. United States, 98 U.S. 145, 158-59 (1879)); *see also* Motes v. United States, 178 U.S. 458, 471 (1900) (holding that admitting ex parte deposition testimony would violate the defendant's right to confront his accusers unless the declarant was "absent from the trial by suggestion, procurement, or act of the accused").

210. Reynolds v. United States, 98 U.S. 145, 159 (1878).

211. *Id.* at 158.

212. *See Crawford*, 541 U.S. at 62.

213. Domestic violence is another context in which prosecutors may seek to expand the forfeiture exception. *See* Adam M. Krischer, *"Though Justice May be Blind, It Is Not Stupid": Applying Common Sense to* Crawford *in Domestic Violence Cases*, 38 PROSECUTOR 14, 14 (2004) (suggesting that the judiciary and public may need to be educated over time to accept the view that domestic violence almost always involves forfeiture).

The primary objection is that this use of forfeiture is bootstrapping: The wrongful act that allegedly rendered the witness unavailable is the very act with which the accused is charged (and presumed not to have committed).[214] However, a commentator has suggested that this is analogous to courts' regular admission of hearsay statements made by a conspirator of the defendant in support of the conspiracy that the defendant is currently charged with committing.[215] Post-*Crawford*, courts have held that it is proper to apply the forfeiture doctrine when the act rendering the witness unavailable is the same act with which the defendant is charged.[216] The Federal Rules of Evidence require corroborating evidence of the conspiracy before admitting co-conspirator statements.[217] Based on this requirement, courts may ask for corroborating evidence of abuse before admitting out-of-court statements of a child victim to show that abuse by the defendant procured the victim's unavailability and constituted a waiver of his Confrontation Clause rights. Even so, the bootstrapping argument should not prevent use of the forfeiture doctrine in the child abuse context.

A second objection to this application is that the defendant did not act with the purpose of rendering the witness unavailable.[218] This requirement of intentional procurement, if it is even appropriate to apply to forfeiture under the Confrontation Clause, should not prevent use of the doctrine in a child abuse context. First, with child abuse, there is evidence that the procurement is intentional, as abusers will often tell victims that the acts are "secret" and that they should not tell, actions apparently "intended to prevent the child from disclosing [the abuse] and testifying against the abuser."[219] Second, a

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214. Friedman, *supra* note 157, at 12.

215. *Id.*; *see* FED. R. EVID. 801(d)(2)(E). Statements "by a coconspirator of a party during the course and in furtherance of the conspiracy" are not hearsay, even when admitted against a defendant who is actually charged with the very conspiracy which renders the statement admissible. FED. R. EVID. 801(d)(2)(E).

216. *See* State v. Meeks, 88 P.3d 789, 793-94 (Kan. 2004) (holding that admission of testimonial hearsay did not violate the homicide defendant's Confrontation Clause rights because the defendant forfeited such rights when he killed the declarant/victim); People v. Moore, No. 01CA1760, 2004 Colo. App. LEXIS 1354 (Colo. Ct. App. July 29, 2004) (holding that the defendant waived his right to confrontation when the victim was unable to testify because her death was the result of the defendant's actions).

217. FED. R. EVID. 801(d)(2)(E).

218. Friedman, *supra* note 157, at 12. This argument likely rests on the last sentence of Federal Rule of Evidence 804(a), which defines unavailability of a declarant for purposes of the hearsay doctrine. The rule states, in relevant part, "[a] declarant is not unavailable as a witness if exemption, refusal, claim of lack of memory, inability, or absence is due to the procurement or wrongdoing of the proponent of a statement *for the purpose of preventing the witness from attending or testifying*." FED. R. EVID. 804(a) (emphasis added).

219. *See* Tom Harbison, *Using the* Crawford v. Washington *"Forfeiture by Wrongdoing" Confrontation Clause Exception in Child Abuse Cases*, REASONABLE EFFORTS (National District Attorneys Association, American Prosecutors Research Institute), Volume 1, Number 3, 2004,

commentator suggests that the requirement of intentional procurement, inasmuch as it originated under the Federal Rules of Evidence for application in a hearsay analysis, should not be required in a forfeiture analysis under the Confrontation Clause.[220] The basic rationale behind the forfeiture doctrine—that the defendant should not profit from his bad acts—supports the conclusion that the appropriate question should not be *when* the bad act occurred, but whether the act caused the unavailability and was incompatible with maintaining the right to confrontation.[221]

Arguments for application of the forfeiture doctrine in cases where the abuse itself is shown to have procured the child victim's absence are strong. Abusers will commonly tell victims not to tell, threaten the victim, their family, or even pets if the child tells; or abusers will ask others, like family members, to keep the child from telling.[222] Courts have found procurement of a witness's unavailability, although not necessarily in a child abuse context, by "persuasion, the wrongful disclosure of information, control by the suspect, acquiescence in others performing acts of procurement, and asking others to persuade the witness not to testify."[223] Prior to *Crawford*, it was recognized that the abuse itself could render a victim unavailable to testify, without any subsequent act of procurement by the defendant.[224] If post-*Crawford* courts continue to recognize or expand the exception for forfeiture by wrongdoing in child abuse cases, *Crawford* and the Confrontation Clause should not affect child hearsay exceptions or protective procedures where the prosecution can show that the abuse itself caused the victim's unavailability.

D. Public Policy Supports Continued Use of Child Witness Protections

Finally, policy and public pressure on the courts mitigate in favor of interpretations that allow continued use of child hearsay exceptions. The established purpose of the Confrontation Clause is to further the truth-seeking function of trial.[225] In child abuse prosecutions, requiring the witness to face the

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available at http://www.ndaa-apri.org/publications/newsletters/reasonable_efforts_volume_1_number_3_2004.html (last visited Aug. 31, 2005).

220. Richard Friedman, The Confrontation Blog: A Strange Federal Opinion on Dying Declarations and Forfeiture, http://www.confrontationright.blogspot.com/2005/03/strange-federal-opinion-on-dying.html (Mar. 28, 2005) ("Whether the confrontation right is forfeited is a matter of federal constitutional law, and there is no reason why the constitutional standard of forfeiture must conform to the Federal Rules' expression of the doctrine.").

221. *See* Harbison, *supra* note 219; Friedman, *supra* note 157, at 12.

222. Harbison, *supra* note 219.

223. *Id.* Harbison cites several cases in which the defendant procured a witness's unavailability. *Id.* at n.20.

224. *See* New Jersey v. Sheppard, 484 A.2d 1330 (N.J. Super Ct. Law Div. 1984) (holding that the defendant waived his right to confrontation at his trial for child abuse by procuring the victim's unavailability through acts committed during the crime).

225. Crawford v. Washington, 541 U.S. 36, 61 (2004) ("[T]he Clause's ultimate goal is to

defendant in court or answer questions on cross-examination may not serve this purpose.[226] The Court in *Craig* stated that "[w]here face-to-face confrontation causes significant emotional distress in a child witness, there is evidence that such confrontation would in fact *disserve* the Confrontation Clause's truth-seeking goal."[227] The nature of child witnesses and child abuse prosecutions begin to illustrate why adversarial testing may not be the best guarantor of reliability.[228] Few lawyers can effectively cross examine a child witness, a task that requires great sensitivity and skill.[229] It is also suggested that jurors may not be able to evaluate accurately what they see and hear from such a witness.[230] If face-to-face confrontation and adversarial testing do not serve the purposes of confrontation, and may even disserve its purposes, it is unclear whether courts can justify the potential harm done to child witnesses in carrying out the mandates of *Crawford*.

Crawford is seen as a barrier to the admission of many previously-admissible statements. Because of the damaging impact to prosecutions in the already politically-charged context of child sexual abuse, there will be public pressure on courts to narrow the definition of testimonial statements, and to expand the scope of other exceptions, to minimize *Crawford*'s impact.[231] This public and political pressure, as well as the uncertainty about whether *Crawford*'s mandates will further the truth-seeking goals of confrontation, supports lower court interpretations that minimize or eliminate any impact *Crawford* may have on child hearsay exceptions and protective in-court procedures for child witnesses.

CONCLUSION

Much of the commentary following *Crawford* was quick to state that the decision brought about a radical change in Confrontation Clause jurisprudence. Doubtless, *Crawford* has changed the way courts must evaluate the admission of testimonial out-of-court statements. However, it is not clear whether this new analysis will keep many previously admissible hearsay statements out of court. Although it appears to be a dramatic change, *Crawford* may not bring about such

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ensure reliability of evidence."); Maryland v. Craig, 497 U.S. 836, 845 (1990) ("The central concern of the Confrontation Clause is to ensure the reliability of the evidence against a criminal defendant . . . ."); Ohio v. Roberts, 448 U.S. 56, 65 (1980) (stating that the Clause's purpose is to "augment accuracy in the factfinding process").

226. Although the author feels there is no better alternative, he suggests that adversary testing may not lead to reliable and trustworthy evidence from children. Mosteller, *supra* note 132, at 593.

227. *Craig*, 497 U.S. at 857 (citing Coy v. Iowa, 487 U.S. 1012, 1032 (1988) (Blackmun, J., dissenting) (stating that face-to-face confrontation "may so overwhelm the child as to prevent the possibility of effective testimony, thereby undermining the truth-finding function of the trial itself")).

228. *See* Mosteller, *supra* note 132, at 593.

229. *Id.*

230. *Id.*

231. *Id.* at 516.

dramatic changes in the courtroom. In particular, the author of this Note feels that *Crawford* is unlikely to have a damaging impact on child abuse prosecutions. *Crawford* should not be construed to prevent prosecutors from using techniques to protect child witnesses, including in-court protective procedures and evidentiary rules allowing the use of hearsay statements by child victims. The defendant's right to confrontation is not to be ignored or taken lightly. However, to allow *Crawford* to act as a road block to child abuse prosecutions would present an even greater risk to the Confrontation Clause's ultimate truth-seeking function.

TRUE BELIEVERS?: PROBLEMS OF DEFINITION IN TITLE VII RELIGIOUS DISCRIMINATION JURISPRUDENCE

SUSANNAH P. MROZ*

INTRODUCTION

Imagine that you are an owner of a retail store. Your employees regularly come into contact with the public. To foster an image that appeals to customers, you adopt a dress code for all employees. The dress code requires employees to wear uniforms and to keep their hair neatly trimmed. In addition, it forbids employees to display facial piercings while they work. One of your employees has several facial piercings, including an eyebrow ring. When you announce your no-facial-piercing policy, she refuses to remove the piercing, saying that it is part of her "religion." After further inquiry, you learn that she is a member of the "Church of Body Modification," a church based on the Internet which encourages piercings and tattoos. What do you do? Must you accommodate her "religion"? If you fire her, can she sue you for "religious discrimination"?

Now imagine that your dress code also requires men to be clean-shaven. One of your employees has a beard. When you announce your no-facial-hair policy, he refuses to shave his beard, saying that it is part of his "religion." After further inquiry, you learn that he is a Sikh and that his religion forbids him to shave his facial hair. What do you do? Do you react differently than you did with the member of the Church of Body Modification?

The preceding hypothetical situations are based on actual cases.[1] They throw into sharp relief an issue that lurks in many cases of religious discrimination brought under Title VII of the Civil Rights Act of 1964: What exactly *is* the "religion" which is protected? More practically, these cases force us to confront basic policy issues: Should members of the Church of Body Modification be protected in a manner similar to Muslims? What about ethical vegans?[2] White supremacists who claim their belief system is "religious"?[3] Ardent Republicans or Democrats? Given the state of the law today, these questions have no clear-

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1. Cloutier v. Costco Wholesale Corp., 390 F.3d 126 (1st Cir. 2004) (discussing no-facial-piercing policy); EEOC v. Sambo's of Georgia, Inc., 530 F. Supp. 86 (D.C. Ga. 1981) (discussing no-facial-hair policy).

2. *See* Friedman v. S. Cal. Permanente Med. Group, 125 Cal. Rptr. 2d 663, 665-66 (2002) (holding that veganism does not constitute a "religion" for purposes of California's Fair Employment and Housing Act because it did not address "ultimate" questions (such as the meaning of life), was insufficiently comprehensive, and gave rise to no formal or external signs).

3. *Compare* Peterson v. Wilmur Commc'ns, Inc., 205 F. Supp. 2d 1014, 1021-24 (E.D. Wis. 2002) (holding that a church that preached a set of white supremacist beliefs called "Creativity" is a "religion" for purposes of Title VII), *with* Slater v. King Soopers, 809 F. Supp. 809 (D. Colo. 1992) (holding that the Ku Klux Klan is not a religion for purposes of Title VII).

cut answers.

This Note analyzes and critiques the prevailing definition of "religion" used to decide religious discrimination suits under Title VII of the Civil Rights Act of 1964 ("Title VII").[4] In Part I, this Note provides a brief introduction to religious discrimination in employment. Part II explores the background of courts' attempts to define religion in the context of Title VII. In particular, it discusses the U.S. Supreme Court's conscientious objector cases and some of its First Amendment jurisprudence. Part III explores the definitions courts purport to use when considering claims of religious discrimination under Title VII. Part IV analyzes and critiques these definitions, suggesting that courts do not follow the radical implications of the Supreme Court's First Amendment jurisprudence when deciding Title VII cases.

I. BRIEF INTRODUCTION TO RELIGIOUS DISCRIMINATION IN EMPLOYMENT

A. The Standards of Title VII

Title VII prohibits various forms of employment discrimination, including discrimination on the basis of religion.[5] This broad prohibition applies to both public and private employers.[6] Title VII provides, in relevant part:

> (a) It shall be an unlawful employment practice for an employer—
>
> > (1) to fail or refuse to hire or to discharge any individual, or otherwise discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's . . . religion . . . ; or
> >
> > (2) to limit, segregate, or classify his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's . . . religion.[7]

Title VII defines "religion" to include "all aspects of religious observance and practice, as well as belief."[8]

The EEOC and the courts have interpreted Title VII broadly.[9] The language

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4. 42 U.S.C. §§ 2000e to 2000e-17 (2000).

5. *Id.* § 2000e-2.

6. *Id.* §§ 2000e-16 (prohibiting employment discrimination by the federal government), 2000e(a) (applying the statute to state and local governments), 2000e(b) (defining "employer" to include companies which affect commerce and have fifteen or more employees for twenty or more calendar weeks in the current or preceding calendar year).

7. *Id.* § 2000e-2(a).

8. *Id.* § 2000e(j).

9. Russell S. Post, Note, *The Serpentine Wall and the Serpent's Tongue: Rethinking the*

of the statute itself forbids employers from making certain discriminatory decisions, such as refusing to hire a job applicant simply because he or she is Muslim.[10] Courts have also read the statute to prohibit harassment based on race, sex, national origin, and religion.[11] Under this reading, an employee may sustain a claim for a "hostile work environment" if he or she suffers harassment which is sufficiently severe.[12] In 1972, the EEOC endorsed the viability of hostile work environment claims in the context of religious discrimination, holding that the "failure to provide a working environment free of religious intimidation is violative of Section 703(a) of Title VII [42 U.S.C. § 2000e-2]."[13] Thus, an employee who is repeatedly subjected to anti-Semitic epithets by his or her supervisor may be entitled to relief under Title VII.[14]

In its original form, Title VII did not explicitly require employers to accommodate employees' religious practices. For example, the statute did not seem to require an employer to grant employees time off to attend religious services.[15] In the wake of numerous complaints from employees who had been denied time off for religious observances, the EEOC addressed the issue in its 1966 Guidelines.[16] These guidelines held that an employer could establish a normal work week which was generally applicable to all employees without discriminating on the basis of religion; however, the EEOC also stated that employers should accommodate the religious practices of its employees unless doing so would create a "serious inconvenience to the conduct of the business."[17] In 1967, the EEOC amended its Guidelines to require an employer to make such accommodations unless doing so would cause "undue hardship."[18] This amendment seemed to confer upon employers an affirmative obligation to excuse employees from work to attend religious services. Most courts refused to impose this burden on employers.[19]

In 1972, Congress amended Title VII. In so doing, it followed the EEOC Guidelines and explicitly required employers to accommodate the religious

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Religious Harassment Debate, 83 VA. L. REV. 177, 181 (1997).

10. 42 U.S.C. § 2000e-2.

11. Post, *supra* note 9, at 181-82.

12. *Id.*

13. *Id.* at 182 (quoting EEOC Dec. No. 72-1114, 1973 EEOC Decisions (CCH) P 6347 (Feb. 18, 1972)).

14. *See, e.g.*, Shanoff v. Ill. Dep't of Human Servs., 258 F.3d 696 (7th Cir. 2001).

15. *See* Civil Rights Act of 1964, Pub. L. No. 88-352, § 701, 78 Stat. 241, 253 (1964) (codified as amended at 42 U.S.C. § 2000e (2000)). The original version did not include § 701(j), which currently requires employers to accommodate the religious practices of employees. 42 U.S.C. § 2000e(j) (2000).

16. Debbie N. Kaminer, *Title VII's Failure to Provide Meaningful and Consistent Protection of Religious Employees: Proposals for an Amendment*, 21 BERKELEY J. EMP. & LAB. L. 575, 581 (2000).

17. *Id.* (quoting 29 C.F.R. § 1605.1 (1967)).

18. *Id.* (quoting 29 C.F.R. § 1605.1 (1968)).

19. *Id.* at 582.

practices of their employees.[20] It accomplished this by amending Title VII's definition of religion to read: "The term 'religion' includes all aspects of religious observance and practice, as well as belief, *unless an employer demonstrates that he is unable to reasonably accommodate to an employee's or prospective employee's religious observance or practice without undue hardship on the conduct of the employer's business.*"[21]

B. The Meaning of "Reasonable Accommodation"

The U.S. Supreme Court defined the contours of this reasonable accommodation in two landmark cases. In *Trans World Airlines, Inc. v. Hardison*,[22] the Court held that any accommodation imposing more than a *de minimis* cost constitutes an "undue hardship" for the purposes of Title VII. In *Hardison*, the plaintiff belonged to the Worldwide Church of God, a Christian group which required its members to observe the Sabbath by refraining from performing any work from sunset on Friday until sunset on Saturday.[23] He informed his manager of this conflict, and the problem was temporarily solved when he transferred to the night shift, thereby allowing him to observe his Sabbath. When the plaintiff transferred to another position on the day shift, he again faced the possibility of having to work on Saturdays.[24]

When another employee went on vacation, he was asked to work Saturdays. Although the employer agreed to allow the union to seek a change of work assignments for him, the union was not willing to violate the seniority provisions of the collective-bargaining contract and allow the plaintiff to bid for a shift having Saturdays off. The plaintiff proposed that he be allowed to work four days per week. The company rejected this proposal.[25] It argued that the plaintiff's position was essential, so it could not be left open on weekends. Moreover, filling his position with an employee from another area would have harmed other operations. Finally, employing another person who was not normally assigned to work on Saturdays would have required the employer to pay premium wages.[26] An accommodation was never reached, and the plaintiff refused to report for work on Saturdays. Ultimately, he was terminated because he refused to work during his designated shift.[27] He brought suit, alleging religious discrimination in violation of Title VII.

The Court concluded that the employer had not violated Title VII.[28] The

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20. *Id.* at 583.

21. 42 U.S.C. § 2000e(j) (2000) (emphasis added).

22. 432 U.S. 63 (1977).

23. *Id.* at 67; *see also* Johnson v. Angelica Unif. Group, Inc., 762 F.2d 671, 672 (1985) (discussing the tenets of the Worldwide Church of God).

24. Hardison, 432 U.S. at 67-68.

25. *Id.* at 68.

26. *Id.* at 68-69.

27. *Id.* at 69.

28. *Id.* at 70.

Court found that the company had made attempts to accommodate the plaintiff, these attempts were "reasonable" according to the terms of the statute, and requiring the company to do more would have constituted an "undue hardship."[29] Ultimately, the Court held that the "undue hardship" standard of Title VII only required the company to bear a *de minimis* cost. It reasoned:

> To require [the company] to bear more than a *de minimis* cost in order to give [the plaintiff] Saturdays off is an undue hardship . . . . [T]o require [the company] to bear additional costs when no such costs are incurred to give other employees the day off that they want would involve unequal treatment of employees on the basis of their religion. [The suggestion that the company] should incur certain costs in order to give [the plaintiff] Saturdays off . . . would in effect require [the company] to finance an additional Saturday off and then to choose the employee who will enjoy it on the basis of his religious beliefs. While incurring extra costs to secure a replacement for [the plaintiff] might remove the necessity of compelling another employee to work involuntarily in [the plaintiff's] place, it would not change the fact that the privilege of having Saturdays off would be allocated according to religious beliefs.[30]

Noting that Congress was primarily concerned with the elimination of discrimination in employment when it passed Title VII, the Court refused to construe the statute to require an employer to "discriminate against some employees in order to enable others to observe their Sabbath."[31] Thus, the Court established that Title VII only required employers to bear a *de minimis* cost when accommodating the religious practices of their employees.

The Court further narrowed the accommodations required of employers in *Ansonia Board of Education v. Philbrook*.[32] In that case, the plaintiff was a teacher and a member of the Worldwide Church of God. In addition to forbidding work on Saturdays, the group required members to refrain from work on various holy days. Under the terms of the collective bargaining agreement, teachers were allowed three paid days off for religious reasons. In addition, teachers were given three paid personal days off.[33] These personal days could not be used for purposes for which there was already a designated leave. Thus, they could not be used for religious reasons. The plaintiff, however, usually needed to miss about six days per year for religious celebrations. For several years, he used the three days authorized for religious reasons and took unauthorized leave (time without pay) for additional holidays. Eventually the plaintiff became dissatisfied with the arrangement.[34] He suggested two

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29. *Id.* at 77.
30. *Id.* at 84-85.
31. *Id.* at 85.
32. 479 U.S. 60 (1986).
33. *Id.* at 63-64.
34. *Id.* at 64.

alternatives: either he could use his personal leave for additional holy days or he could pay the cost of a substitute teacher for holy days on which he could not work and in return receive full pay. The school district refused these requests, arguing that allowing plaintiff to take unpaid leave constituted a reasonable accommodation.[35] The plaintiff brought suit under Title VII for failure to accommodate his religious practices, arguing that his employer was required to accept one of the accommodations he had proposed because none of his alternatives constituted an "undue hardship."[36]

The Court held that an employer fulfills its duty to accommodate under Title VII so long as it offers a reasonable accommodation to the employee, even if that accommodation is not the employee's preferred accommodation.[37] The Court reasoned:

> We find no basis in either the statute or its legislative history for requiring an employer to choose any particular accommodation. . . . Thus, where the employer has already reasonably accommodated the employee's religious needs, the statutory inquiry is at an end. The employer need not further show that each of the employee's alternative accommodations would result in undue hardship.[38]

Ultimately, the Court remanded the case for consideration of whether the employer's proposed accommodation of unpaid days off constituted a "reasonable accommodation."[39]

C. Causes of Action for Religious Discrimination

Thus, the present interpretation of Title VII allows for three separate causes of action for religious discrimination. First, an employee may bring a case for disparate treatment.[40] To establish a prima facie case of disparate treatment, he or she must show that: (1) he or she adhered to a religious belief system or engaged in religious practices; (2) he or she was qualified for the position; (3) he or she suffered an adverse employment action; and (4) others who do not share his or her religion received more favorable treatment.[41] Second, an employee may bring a claim for religious harassment or hostile work environment.[42] To establish a prima facie case on this claim, he or she must show that: (1) he or she

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35. *Id.* at 65.

36. *Id.* at 62-65.

37. *Id.* at 68.

38. *Id.* (internal citations omitted).

39. *Id.* at 70 (noting that, while unpaid leave usually constitutes a reasonable accommodation, it is not a reasonable accommodation when unpaid leave is allowed for all purposes *except* religious purposes).

40. MICHAEL WOLF ET AL., RELIGION IN THE WORKPLACE: A COMPREHENSIVE GUIDE TO LEGAL RIGHTS AND RESPONSIBILITIES 38 (1998).

41. *Id.* at 43-44.

42. *Id.* at 53.

is a member of a protected religious group; (2) he or she was subjected to unwelcome harassment; (3) the harassment was based on his or her religion; and (4) the harassment affected a term, condition, or privilege of employment.[43] Finally, an employee may bring a claim for failure to accommodate his or her religious practices.[44] To establish a prima facie case under this theory, the employee must show that: (1) he or she has a sincere religious belief that conflicts with an employment requirement; (2) the employer was put on notice of the conflict; and (3) he or she has been disciplined or will otherwise suffer an adverse consequence for adherence to his or her religious belief.[45]

For each cause of action, the employee must show that he or she subscribes to some sort of "religion," such that he or she is entitled to the protection of Title VII. Although the courts have developed sophisticated rubrics to analyze each of the causes of action, the definition of the "religion" that is to be protected remains murky. This confusion results, in part, from the lack of legislative history which might indicate exactly what Congress intended to protect when it incorporated religion into its broad policy of antidiscrimination.[46] Title VII singles out religion for protection by placing it in the same category as race, color, sex, and national origin.[47] The legislative history of the statute reveals no discussion or debate about the rationale for making religion a protected category.[48] Russell S. Post has observed:

> This pervasive silence suggests that religion was included in Title VII as boilerplate language to ensure uniformity of the antidiscrimination principle, not as a function of any compelling policy rationale. This inference is supported by the fact that the earliest antecedents of Title VII, New Deal employment measures, often included prohibitions against discrimination on account of "race, color, or creed," offering easy templates for the drafters of Title VII to adopt verbatim.
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> In retrospect, therefore, the prohibition against religious discrimination looks more like an afterthought than an imperative of public policy.[49]

Thus, courts have been left to develop a definition of religion which accords with the policies behind Title VII. In so doing, they must pay heed to the U.S. Supreme Court's pronouncements concerning religion and the strictures of the First Amendment.

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43. *Id.* at 56.
44. *Id.* at 67.
45. *Id.* at 68.
46. Post, *supra* note 9, at 180-81.
47. 42 U.S.C. § 2000e-2 (2000).
48. Post, *supra* note 9, at 181 n.11.
49. *Id.* at 181.

II. DEFINING "RELIGION": BACKGROUND AND LIMITATIONS

A. Background: The Conscientious Objector Cases and the Definition of "Religion"

Although the U.S. Supreme Court has adopted various definitions of "religion," the approach most often used in religious discrimination cases originates from cases interpreting the conscientious objector exemption to the Universal Military Training and Service Act of 1948.[50] In 1890, the Court adopted a substantive definition, requiring that religion "refer to the belief in and worship of a deity."[51] Some sixty years later, it moved toward a functional definition of religion, holding that the term "religion" did not apply solely to those beliefs which rested on belief in a deity.[52] The Court expanded on this definition in *United States v. Seeger*[53] and *Welsh v. United States*,[54] thereby setting the stage for future cases.

1. "Non-Traditional" Religions: United States v. Seeger.—In *Seeger*, the Court considered several cases involving claims of men who had claimed conscientious objector status under the Universal Military Training and Service Act. Each had been convicted under the Act after refusing to submit to induction in the armed forces.[55] The Act exempted those persons from combatant training and service in the armed forces of the United States "who by reason of their religious training and belief are conscientiously opposed to participation in war in any form."[56] It defined "religious training and belief" as "an individual's belief in relation to a Supreme Being involving duties superior to those arising from any human relation, but [not including] essentially political, sociological, or philosophical views or a merely personal moral code."[57]

The Court concluded that Congress, in using the phrase "Supreme Being," meant to "embrace all religions and to exclude essentially political, sociological, or philosophical views."[58] In developing a test to identify "religious" beliefs under the Act, the Court considered the history of exemptions for conscientious objectors.[59] First, it noted that government has long recognized the "moral dilemma" posed to persons of various religious faiths by the "call to arms."[60] While tracing the development of the exemption, it noted that Congress had

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50. *See* John C. Knechtle, *If We Don't Know What It Is, How Do We Know if It's Established?*, 41 BRANDEIS L.J. 521, 525-26 (2003).

51. *Id.* (citing Davis v. Beason, 133 U.S. 333 (1890)).

52. *Id.* (citing Torcaso v. Watkins, 367 U.S. 488 (1961)).

53. 380 U.S. 163 (1965).

54. 398 U.S. 333 (1970).

55. *Seeger*, 380 U.S. at 166-69.

56. *Id.* at 164 (citing 50 U.S.C. App. § 456(j) (1958)).

57. *Id.* at 165 (quoting 50 U.S.C. App. § 456(j) (1958)) (alteration in original).

58. *Id.* at 165.

59. *Id.* at 171-72.

60. *Id.* at 170.

always continued its practice of "excusing from armed service those who believed that they owed an obligation, superior to that due the state, of not participating in war in any form."[61] Similarly, the Court noted that those who oppose war on the basis of political, sociological, or economic considerations have never been exempted because "[t]hese judgments have historically been reserved for the Government, and in matters which can be said to fall within these areas the conviction of the individual has never been permitted to override that of the state."[62]

After recognizing the difficulty inherent in discussing "spiritual" matters in a religiously pluralistic society,[63] the Court adopted a test of whether a belief is "religious" for purposes of the Act. It held that the appropriate inquiry is "whether a given belief that is sincere and meaningful occupies a place in the life of its possessor parallel to that filled by the orthodox belief in God of one who clearly qualifies for the exemption."[64] In characterizing this test, the Court quoted approvingly Protestant theologian Paul Tillich's conception of God as "the source of your being, of your ultimate concern, *of what you take seriously without any reservation*."[65]

The Court applied this test to three separate claimants. Seeger declared that he was conscientiously opposed to participation in war in any form because of his "religious" beliefs.[66] He preferred to leave the question of his belief in a Supreme Being open. He characterized his "religion" as a "belief in and devotion to goodness and virtue for their own sakes, and a religious faith in a purely ethical creed."[67] Seeger cited Plato, Aristotle, and Spinoza to support his belief in intellectual and moral integrity "without belief in God, except in the remotest sense."[68] His claim for conscientious objector status had been denied because it was deemed not to be based on a "belief in relation to a Supreme Being," as required by the Act.[69] The Court reversed his conviction, finding that his belief system was sufficiently "religious" to satisfy the requirements of the Act.[70] It reasoned:

> In summary, Seeger professed "religious belief" and "religious faith." He did not disavow any belief "in a relation to a Supreme Being"; indeed he stated that "the cosmic order does, perhaps, suggest a creative intelligence." He decried the tremendous "spiritual" price man must pay for his willingness to destroy human life. . . . We think it clear that the

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61. *Id.* at 172.
62. *Id.* at 173.
63. *Id.* at 174-76.
64. *Id.* at 166.
65. *Id.* at 187 (quoting PAUL TILLICH, THE SHAKING OF THE FOUNDATIONS 57 (1948)).
66. *Id.* at 166.
67. *Id.*
68. *Id.*
69. *Id.* at 167.
70. *Id.* at 187.

> beliefs which prompted his objection occupy the same place in his life as the belief in a traditional deity holds in the lives of his friends, the Quakers.[71]

Jakobson also claimed conscientious objector status. He stated that he "believed in a 'Supreme Being' who was 'Creator of Man' in the sense of being 'ultimately responsible for the existence of' man and who was the 'Supreme Reality' of which 'the existence of man is the *result.*'"[72] He stated that he believed in "Godness" which he defined as "the Ultimate Cause for the fact of the Being of the Universe."[73] He had concluded that his "most important religious law" was that "no man ought ever to willfully sacrifice another man's life as a means to any other end."[74] He represented that his religious and social thinking were the product of meditation and thought.[75] His claim was originally denied because it was based upon a "personal moral code," as opposed to a "religion."[76] The Court reversed his conviction, reasoning that his belief in opposition to war was "related to a Supreme Being."[77]

Peter was also convicted under the Act after he refused to submit to induction.[78] In his application for a conscientious objector exemption, he had stated that he was not a member of a religious sect or organization. He hedged the question as to his belief in a Supreme Being, but quoted with approval a definition of religion as "the consciousness of some power manifest in nature" and "the supreme expression of human nature."[79] When asked directly about his belief in a Supreme Being, he stated that he supposed "you could call that a belief in the Supreme Being or God. These just do not happen to be the words I use."[80] The Court reversed his conviction, finding that his reference to "some power manifest in nature" and his acknowledgment that his beliefs could be characterized as a belief in a Supreme Being were sufficiently "religious" to qualify for exemption under the Act.[81]

2. "Nonreligious" Belief Systems: Welsh v. United States.—Having expanded the conscientious objector exemption to persons who professed "non-traditional" views of God in *Seeger*, the Court considered the status of those who characterized their belief systems as "nonreligious" in *Welsh v. United States*.[82] Welsh's application for conscientious objector status was denied, and he was

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71. *Id.*
72. *Id.* at 167.
73. *Id.* at 168.
74. *Id.*
75. *Id.*
76. *Id.*
77. *Id.* at 187.
78. *Id.* at 169.
79. *Id.* at 169.
80. *Id.*
81. *Id.* at 187-88.
82. 398 U.S. 333 (1970).

convicted under the Act after he refused to submit to induction into the Armed Forces.[83] Welsh was unable to sign the statement printed on the Selective Service Form which stated, "I am, by reason of my religious training and belief, conscientiously opposed to participation in war in any form."[84] He signed only after striking out the words "my religious training and" from the form.[85] Later, he indicated that his beliefs had been formed by reading in the fields of history and sociology.[86] Welsh preferred to leave the question of whether he believed in a "Supreme Being" open.[87] Although he indicated that he believed the taking of human life was morally wrong,[88] his original application characterized his beliefs as nonreligious.[89] While the Selective Service conceded that Welsh's beliefs were held "with the strength of more traditional religious convictions,"[90] his original application for conscientious objector status was denied because his beliefs were deemed insufficiently "religious."[91]

The Court overturned Welsh's conviction. In so doing, it extended the *Seeger* definition of "religious" to include beliefs which the believer does not even characterize as "religious."[92] The Court discounted the government's reliance on Welsh's own interpretation of his beliefs as "nonreligious," saying, "We think this attempt . . . fails for the reason that it places undue emphasis on the registrant's interpretation of his own beliefs."[93] Moreover, the Court rebuffed the suggestion that Welsh's beliefs constituted "essentially political, sociological, or philosophical views or a merely personal code."[94] Although the Court recognized that Welsh's conscientious objection was based in part on his perception of world politics, it reasoned that the definition of "religious" need not exclude political, economic, or philosophical views. The Court noted:

> Once the Selective Service System has taken the first step and determined under the standards set out here and in *Seeger* that the registrant is a "religious" conscientious objector, it follows that his views cannot be "essentially political, sociological, or philosophical." Nor can they be a "merely personal moral code."[95]

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83. *Id.* at 335-38.

84. *Id.* at 336-37.

85. *Id.* at 337.

86. *Id.* at 341.

87. *Id.* at 336-37.

88. *Id.* at 343.

89. *Id.* at 341-42. Subsequently, Welsh wrote a letter to the Appeal Board which stated that his beliefs *were* religious "in the ethical sense of the word," although not "in the conventional sense." *Id.*

90. *Id.* at 337.

91. *Id.*

92. *Id.* at 341.

93. *Id.*

94. *Id.* at 342.

95. *Id.* at 343.

Thus, the Court concluded, Welsh's belief that killing was morally wrong was sufficiently religious to entitle him to a conscientious objector exemption.[96] In so holding, the Court defined the Act's definition of "religious" in the most expansive terms: "That section exempts from military service all those whose consciences, spurred by deeply held moral, ethical, or religious beliefs, would give them no rest or peace if they allowed themselves to become a part of an instrument of war."[97]

B. Limitations: First Amendment Jurisprudence and the Definition of "Religion"

Although the Court avoided constitutional issues in both *Seeger* and *Welsh*, its definition of "religious" was necessarily limited by the First Amendment. The First Amendment of the U.S. Constitution provides: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . . . ."[98] The U.S. Supreme Court has recognized that this deceptively simple phrase limits the federal government's ability to define "religion" and the judiciary's ability to inquire into "religious" matters.[99]

1. Judicial Inquiry into "Religious" Matters.—Most obviously, the First Amendment forecloses judicial inquiry into "religious" matters. Specifically, courts cannot rule on the truth or falsity of a theological statement.[100] In *United States v. Ballard*,[101] the U.S. Supreme Court noted that such a ruling would violate the Free Exercise Clause:

> Freedom of thought, which includes freedom of religious belief, is basic in a society of free men. It embraces the right to maintain theories of life and of death and of the hereafter which are rank heresy to followers of the orthodox faiths. Heresy trials are foreign to our Constitution. Men may believe what they cannot prove. They may not be put to the proof of their religious doctrines or beliefs. Religious experiences which are as real as life to some may be incomprehensible to others. Yet the fact that they may be beyond the ken of mortals does not mean that they can be made suspect before the law. Many take their gospel from the New Testament. But it would hardly be supposed that they could be tried before a jury charged with the duty of determining whether those teachings contained false representations. The miracles of the New Testament, the Divinity of Christ, life after death, the power of prayer are deep in the religious convictions of many. If one could be sent to jail

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96. *Id.* at 343-44.

97. *Id.* at 344.

98. U.S. CONST. amend. I.

99. *See* KATHLEEN M. SULLIVAN & GERALD GUNTHER, FIRST AMENDMENT LAW 466-68 (1998) (discussing the attempt to define religion within the confines of the First Amendment).

100. DONALD A. FARBER, THE FIRST AMENDMENT 269 (2d ed. 2003).

101. 322 U.S. 78 (1944).

> because a jury in a hostile environment found those teachings false, little indeed would be left of religious freedom.[102]

Although courts are more willing to consider the "sincerity" of religious beliefs, the First Amendment also limits this inquiry. In general, any person wishing to take advantage of a religious exemption may be required to establish the "sincerity" of his religious belief.[103] Nonetheless, a court's "sincerity" analysis does have limits.

In *Thomas v. Review Board of the Indiana Employment Security Division*,[104] the U.S. Supreme Court addressed the status of apparently "inconsistent" religious beliefs. Thomas was a Jehovah's Witness, who quit his job after learning that he was working in the production of weapons.[105] After quitting, he applied for unemployment compensation benefits. At an administrative hearing, he testified that contributing to the production of arms violated his religion.[106] The compensation board initially denied his application for benefits because it concluded that he had quit for "personal" reasons.

Thomas challenged this decision, arguing that it violated his Free Exercise rights.[107] The Supreme Court of Indiana rejected this claim, characterizing his choice to quit his job as a "personal philosophical choice rather than a religious choice."[108] In reaching this conclusion, the court placed weight on the fact that Thomas said he was "struggling" with his beliefs and on Thomas's inability to articulate his beliefs precisely.[109] It also noted that another Jehovah's Witness employed at the plant did not object on religious grounds to working on weapons.[110]

The U.S. Supreme Court reversed this decision, finding that Thomas' beliefs were entitled to protection under the First Amendment, even if they seemed unclear or irrational. It noted:

> We see, therefore, that Thomas drew a line, and it is not for us to say that the line he drew was an unreasonable one. Courts should not undertake to dissect religious beliefs because the believer admits he is 'struggling' with his position or because his beliefs are not articulated with the clarity and precision that a more sophisticated person might employ.[111]

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102. *Id.* at 86-87 (internal citation omitted).

103. FARBER, *supra* note 100, at 269; *see, e.g.*, Int'l Soc'y for Krishna Consciousness, Inc. v. Barber, 650 F.2d 430, 441-43 (2d Cir. 1981) (examining the "sincerity" of devotees of the Krishna Consciousness religion).

104. 450 U.S. 707 (1981).

105. *Id.* at 710.

106. *Id.* at 710-11.

107. *Id.* at 713.

108. *Id.*

109. *Id.* at 714.

110. *Id.* at 715.

111. *Id.*

Thus, for the Court, it was enough that Thomas seemed to have an "honest conviction that such work was forbidden by his religion."[112]

The *Thomas* case highlights the difficulty of distinguishing between a determination of a religion's truth and an inquiry into a believer's sincerity. Dissenting in *Ballard*, Justice Jackson noted how difficult this distinction can be.[113] Simply stated, humans find it "hard to conclude that a particularly fanciful or incredible belief can be sincerely held."[114] Thus, "sincerity" determinations often run the risk of becoming "truth" determinations, which are forbidden under the First Amendment. It is not surprising that courts are often reluctant to engage in such an analysis.[115]

2. Limitations on Defining "Religion."—More subtly, the First Amendment proscribes the ability of the government to define "religion." Concurring in *Welsh v. United States*, Justice Harlan construed the conscientious objector cases in constitutional terms.[116] He interpreted the Act to include *only* theistic religions in its definition of "religious."[117] Such a definition, in his eyes, violated the Free Exercise Clause because it favored adherents of religions that worship a "Supreme Being."[118] Moreover, insofar as it distinguished between arguably "religious" groups, such a definition ran afoul of the Equal Protection Clause of the Fourteenth Amendment to the U.S. Constitution.[119] Congress and the courts, then, are limited in their ability to define "religion." The mandates of the First Amendment virtually compel a broad definition, at least for Free Exercise purposes.[120]

To say the least, such an expansive definition has radical implications. Taken on their face, the Supreme Court's definitions suggest that many beliefs and practices not typically considered to be "religious" may qualify for the protection of the First Amendment. For example, a person who is denied a job

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112. *Id.* at 716.

113. United States v. Ballard, 322 U.S. 78, 93 (1944) (Jackson, J., dissenting).

114. Int'l Soc'y for Krishna Consciousness, Inc. v. Barber, 650 F.2d 430, 441 (2d Cir. 1981).

115. *See, e.g.*, EEOC v. Unión Independiente de la Autoridad de Acueductos y Alcantarillados, 279 F.3d 49, 57 (1st Cir. 2002) (quoting Philbrook v. Ansonia Bd. of Educ., 757 F.2d 476, 482 (2d Cir. 1985)) (warning that courts must make sure that "sincerity" analysis not turn on the factfinder's own idea of what a religion should be).

116. Welsh v. United States, 398 U.S. 333, 356-58 (1970) (Harlan, J., concurring).

117. *Id.* at 357 (finding that the Act's explicit reference to belief in a Supreme Being "excludes from its 'scope' individuals motivated by teachings of nontheistic religions, and individuals guided by an inner ethical voice that bespeaks secular and not 'religious' reflection").

118. *Id.* at 358. It should also be noted that Justice Harlan thought that the Act also offended the Establishment Clause because it accorded advantages to "religious" adherents but not to individuals guided by purely moral, ethical, or philosophical sources. *Id.*

119. *Id.* at 357.

120. *See* Knechtle, *supra* note 50, at 528-30 (discussing the suggestion of some scholars that the courts adopt a broad definition for Free Exercise purposes and a narrow definition for Establishment Clause purposes); SULLIVAN & GUNTHER, *supra* note 99, at 468 (same).

after refusing to receive an inoculation which was grown in chicken embryos because he is an "ethical vegan" would seem to have just as colorable a claim to religious discrimination as an employee who is denied a job after refusing a vaccination because she is a Jehovah's Witness.[121] Similarly, an employee who is fired because of his sincerely held scientific beliefs about the Big Bang might be protected under Title VII.[122] Given this background, how do courts apply the definition of "religion" in practice? The next section of this Note explores the definitions courts purport to use when considering claims of religious discrimination under Title VII.

III. On the Front Lines: Defining "Religion" in Employment Discrimination Cases

Understanding the "religion" in religious discrimination cases brought under Title VII can be a daunting task. The cases almost universally purport to apply the definition of "religion" contained in *Welsh* and *Seeger*.[123] Courts are, however, reluctant to probe too deeply into questions of "religion." Thus, it can be difficult to grasp the contours of the "religion" which they purport to protect. Nonetheless, courts occasionally offer hints of the definition which they are using. Sometimes, they address the issue directly. More often, they address the issue indirectly, while considering the "sincerity" of a religious belief or the existence of a legitimate "conflict" between a religious belief or practice and a requirement of employment. The remainder of this section attempts to parse out a definition of "religion" by examining several examples of such cases.

A. "It is No Business of the Courts . . ."[124]—Except When It Is

For the reasons discussed in Part II, courts are reticent to inquire into the "religious" quality of beliefs and practices. This pattern holds true in Title VII religious discrimination cases. Even the most casual survey of cases reveals that the vast majority refrain from this inquiry.[125] Occasionally courts invoke the

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121. *But see* Friedman v. Southern Cal. Permanente Med. Group, 125 Cal. Rptr. 2d 663, 686 (Cal. Ct. App. 2002) (holding that veganism was not a "religious creed").

122. *But see* Captain (Ret.) Drew A. Swank, *Cold Fusion Confusion: The Equal Employment Opportunity Commission's Incredible Interpretation of Religion in* LaViolette v. Daley, Army Law., Mar. 2002, at 74 (criticizing an EEOC decision which held that unusual beliefs regarding cold fusion and other "scientific" beliefs are entitled to the same protection from discrimination as other, more traditionally "religious" beliefs).

123. The cases are too numerous to cite, but it is worth noting that the EEOC explicitly adopted the definition of religion as developed in *Seeger* and *Welsh*. *See* 29 C.F.R. § 1605.1 (2005) ("[T]he Commission will define religious practices to include moral or ethical beliefs as to what is right and wrong which are sincerely held with the strength of traditional religious views. This standard was developed in [*Seeger* and *Welsh*].").

124. Fowler v. Rhode Island, 345 U.S. 67, 70 (1953).

125. *See, e.g.*, Favero v. Huntsville Indep. Sch. Dist., 939 F. Supp. 1281, 1286 (S.D. Tex. 1996) (assuming, without analysis, that beliefs stemming from membership in the Worldwide

mantra of *Fowler v. Rhode Island*, saying, "[I]t is no business of courts to say that what is a religious practice or activity for one group is not religion . . . ."[126] For example, in *Heller v. EBB Auto Co.*, the U.S. Court of Appeals for the Ninth Circuit quoted this language in the course of finding that even a religious practice which is not obviously "mandatory" may qualify for protection under Title VII.[127] Oftentimes, courts simply gloss over the issue of whether or not a belief is "religious,"[128] despite the fact that every plaintiff in a religious discrimination case bears the burden of proving that he or she holds a bona fide religious belief.[129] This reticence is understandable, given the danger of judicial overreaching in this area. Nonetheless, courts sometimes ignore the warning of *Fowler* and engage in an analysis of whether or not a given belief or practice is "religious."

1. Brown v. Pena.—In one of the more infamous cases in religious discrimination jurisprudence, the U.S. District Court for the Southern District of Florida was called upon to evaluate the status of a plaintiff's belief in cat food.[130] In *Brown*, the plaintiff brought suit against the Director of the EEOC after the Director dismissed both of the employment discrimination charges he filed with the Miami District Office.[131] The plaintiff claimed that he had been discriminated against on the basis of his "personal religious creed" that "Kozy Kitten People/Cat Food . . . is contributing significantly to [his] state of well being . . . [and therefore] to [his] overall work performance" by increasing his energy.[132] The EEOC dismissed the charges, finding that the plaintiff's belief was not "religious" within the meaning of Title VII. The plaintiff challenged this dismissal in a lawsuit.

In assessing the plaintiff's claim, the court looked to *Seeger* to define the parameters of "religion."[133] It also referenced a three-factor test utilized by the U.S. Court of Appeals for the Fifth Circuit in determining whether a belief is religious.[134] In characterizing the test, the court stated:

Church of God are "religious"); Anderson v. Gen. Dynamics Convair Aerospace Div., 589 F.2d 397, 410 (9th Cir. 1978) (treating belief that members of the Seventh Day Adventist Church should not contribute to labor organizations as "religious" without analysis); EEOC v. Townley Eng'g & Mfg. Co., 859 F.2d 610, 614 (9th Cir. 1988) (treating atheism as "religious" without analysis).

126. *Fowler*, 345 U.S. at 70.

127. Heller v. EEB Auto Co., 8 F.3d 1433, 1438 (9th Cir. 1993).

128. *See, e.g.*, Smitherman v. Williams-Sonoma, Inc., No. 96 Civ. 5772 (BSJ), 1999 U.S. Dist. LEXIS 12336, at *11-13 (S.D.N.Y. Aug. 11, 1999) (considering plaintiff's religious discrimination claim without mention of whether her Rastafarian beliefs constitute "religion" for purposes of Title VII).

129. *See supra* text accompanying notes 38-43.

130. Brown v. Pena, 441 F. Supp. 1382 (S.D. Fla. 1977).

131. *Id.* at 1383.

132. *Id.* at 1384 (alterations in original).

133. *Id.*

134. *Id.* at 1385 (citing Brown v. Dade Christian Schools, Inc., 556 F.2d 310, 324 (5th Cir. 1977) (Roney, J., dissenting)).

> [T]he "religious" nature of a belief depends on (1) whether the belief is based on a theory of "man's nature or his place in the Universe," (2) which is not merely a personal preference but has an institutional quality about it, and (3) which is sincere. It is significant that throughout these carefully reasoned opinions runs the exclusion of unique personal moral preferences from the characterization of religious beliefs.[135]

The court concluded that the plaintiff's belief in pet food did not qualify as a religion. It reasoned: "Plaintiff's 'personal religious creed' concerning Kozy Kitten Cat Food can only be described as such a mere personal preference and, therefore, is beyond the parameters of the concept of religion as protected by the [C]onstitution or, by logical extension, [Title VII]."[136]

Although the court analyzed the plaintiff's religion only briefly, its enumeration of a "test" for religion suggests that his belief system was deficient in several respects. First, it was not based on a theory of "man's nature or his place in the Universe." Second, it was insufficiently "institutional," and thus doomed to the category of the "merely personal preference." Finally, the court seems to imply that his purported belief was not "sincere."

While the claims of this plaintiff were extreme, the court's analysis reflects the notion that *some* beliefs are simply *not* within the gambit of the "religious." Such beliefs are apparently so *clearly* not "religious" that the court does not even bother to analyze their status fully. In *Brown*, the court seems to be looking for certain landmarks that would indicate the presence of a religion: a theory of man's place in the universe, institutional manifestations, and sincerity. When it fails to find any of these markers, it dismisses the possibility that such a belief system is "religious." The *Brown* court probably came to the correct conclusion—at least regarding this plaintiff—but its method could be more problematic when applied to other belief systems.

2. Fraser v. New York City Board of Education.—In *Fraser v. New York City Board of Education*,[137] the U.S. District Court for the Southern District of New York held that a plaintiff could not sustain a claim for religious discrimination because he did not characterize his beliefs as "religious."[138] The plaintiff, an African-American male, brought suit against his former employer, alleging that he had been discriminated against on the basis of—among other things—religion. He said that he had been discriminated against because he was a Hebrew Israelite.[139]

The court dismissed his claim of religious discrimination. It found that the plaintiff had failed to carry his burden of showing that he had a "bona fide religious belief."[140] It reasoned that the plaintiff could not succeed because he

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135. *Id.* (citing Brown, 556 F.2d at 324 (Roney, J., dissenting)) (internal citation omitted).

136. *Id.*

137. No. 96 Civ. 0625 (SHS), 1998 U.S. Dist. LEXIS 1338 (S.D.N.Y. Feb. 10, 1998).

138. *Id.* at *16.

139. *Id.* at *11.

140. *Id.* at *15.

did not characterize his belief as religious:

> Here, plaintiff—though referring extensively to the bible—has maintained that Hebrew Israelite "is not a religion," and that "to [a] true Hebrew Israelite who is aware of his Identity he has no religion." Since plaintiff does not claim to have a sincere religious belief that conflicted with his employment, he has failed to present a prima facie case of religious discrimination . . . .[141]

Despite the guidance of *Welsh*, the court concluded that a belief cannot be "religious" if the believer says it is "not religion."

3. Slater v. King Soopers, Inc.—Courts face difficult issues when confronted with white supremacists who claim that they have been discriminated against on the basis of their religion. In *Slater*, the U.S. District Court for the District of Colorado held that the Ku Klux Klan did not constitute a "religion" for purposes of Title VII.[142] The employee alleged that he had been discharged because of an "Adolph [sic] Hitler Rally" which he had organized and in which he had participated as part of his affiliation with the Ku Klux Klan.[143] Citing the definition of "religion" found in *Seeger* and *Welsh*, the court determined that the employee's belief system did not qualify for protection:

> As stated by one court when faced with the issue here presented:
> "the proclaimed racist and anti-semitic ideology of the organization to which [the plaintiff] belongs takes on . . . , a narrow, temporal and political character inconsistent with the meaning of 'religion' as used in § 2000e."[144]

The court also cited with approval the EEOC's determination that the Ku Klux Klan did not constitute a "religion" because it was essentially a political and social group.[145] Ultimately, the court concluded, membership in the Ku Klux Klan did not qualify as "religious" for purposes of Title VII.

The *Slater* court's analysis is remarkable insofar as it suggests that some beliefs may simply be too repugnant to qualify as "religious." On its face, the court is implying that an avowedly racist and anti-Semitic ideology *cannot* be "religious" because it is too narrow, too temporal, and too political. Apparently, then, "religions" are *not* narrow, *not* temporal, and *not* political.[146] This suggests that "religions" should be expansive, focused on some time other than the here-and-now, and apolitical. For the *Slater* court, at least, a white supremacist ideology could never qualify as religious.

4. Peterson v. Wilmur Communications, Inc.—In direct contrast to *Slater,* the U.S. District Court for the Eastern District of Wisconsin held that a white

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141. *Id.* at *16 (internal citation omitted) (alteration in original).

142. Slater v. King Soopers, Inc., 809 F. Supp. 809, 810 (D. Colo. 1992).

143. *Id.*

144. *Id.* (quoting Bellamy v. Mason's Stores, Inc., 368 F. Supp. 1025, 1026 (E.D. Va. 1973)).

145. *Id.* (citing EEOC Dec. No. 79-06 (Oct. 6, 1978)).

146. *Id.*

supremacist "church" constituted a "religion" for purposes of Title VII.[147] In *Peterson*, the employee alleged that he had been demoted on the basis of his religious beliefs. He was a follower of the World Church of the Creator. This organization preached a system of beliefs called "Creativity." The central tenet of Creativity was white supremacy.[148] Although Creativity did not espouse a belief in God, an afterlife, or a Supreme Being, it considered itself to be a religion.[149] One of its central texts was entitled "The White Man's Bible."[150] In the words of the court, Creativity taught that its adherents should "live their lives according to the principle that what is good for white people is the ultimate good and what is bad for white people is the ultimate sin."[151] The plaintiff was a "reverend" in the World Church of the Creator.[152]

During the plaintiff's employment with the defendant employer, an article appeared in the local newspaper which discussed the World Church of the Creator. The article contained an interview with the plaintiff and described his involvement in the church and his beliefs. In addition, the article included a photograph of the plaintiff holding a T-shirt bearing the image of a man who, while carrying a copy of "The White Man's Bible," had targeted African-American, Jewish, and Asian people in a two-day shooting spree in Indiana and Illinois before shooting himself in the summer of 1999.[153] When the plaintiff returned to work, the president of the company suspended him without pay. Two days later, he was demoted. His employer sent him a letter which indicated that he was being demoted because of his involvement in the World Church of the Creator.[154] The plaintiff filed suit, arguing that he had been demoted on the basis of his religion in violation of Title VII.[155]

The court engaged in an extensive consideration of whether or not the plaintiff's belief system qualified as "religious" for the purposes of Title VII. It looked to *Seeger* to define "religion," noting:

> [T]he court should find beliefs to be a religion if they "occupy the same place in the life of the [individual] as an orthodox belief in God holds in the life of one clearly qualified." To satisfy this test, the plaintiff must show that the belief . . . [sic] "'religious' in [his or her] own scheme of things."[156]

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147. Peterson v. Wilmur Commc'ns, Inc., 205 F. Supp. 2d 1014, 1021 (E.D. Wis. 2002).

148. *Id.* at 1015.

149. *Id.* at 1015-16.

150. *Id.* at 1016.

151. *Id.*

152. *Id.*

153. *Id.*

154. *Id.*

155. *Id.* at 1016-17.

156. *Id.* at 1018 (quoting United States v. Seeger, 380 U.S. 163, 184 (1965) and Redmond v. GAF Corp., 547 F.2d 897, 901 n.12 (7th Cir. 1978)) (internal citation omitted) (alteration in original).

The court also indicated that a belief system need not have a concept of God and that "[p]urely 'moral and ethical beliefs' can be religious 'so long as they are held with the strength of religious convictions.'"[157] Finally, the court noted that it must give great deference to a believer's own characterization of his belief as "religious."[158]

Applying this test to the plaintiff's belief system, the court found that Creativity "functions as" a religion for the plaintiff.[159] The court pointed to several pieces of evidence to support its conclusion. First, it noted that the plaintiff considered Creativity to be his religion. Next, it emphasized the oath which plaintiff had taken upon becoming a minister.[160] Thus, it concluded that Creativity functioned as a religion in the life of the plaintiff.

The court also discounted suggestions that Creativity could not be a religion because other white supremacist organizations had been previously adjudged not to be religions.[161] First, the court noted: "the fact that certain white supremacist organizations have been found not to be religions does not logically mean that Creativity also is not a religion for [the] plaintiff, given that the test for what is a religion turns in part on subjective factors."[162] The court also suggested that other courts which had rejected the religiosity of white supremacist organizations had not analyzed their status very deeply.[163] The court distinguished the EEOC decision which had determined that the Ku Klux Klan was not a religion for

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157. *Id.* (quoting Welsh v. United States, 398 U.S. 333, 339-40 (1970)).

158. *Id.* (citing *Seeger*, 380 U.S. at 184).

159. *Id.* at 1022.

160. The oath provided, in part:

> Having been duly accepted for the Ministry in the World Church of the Creator, I hereby reaffirm my undying loyalty to the White Race and the World Church of the Creator and furthermore swear . . . that I will fervently promote the Creed and Program of Creativity as long as I live; that I will follow the Sixteen Commandments and encourage others to do the same; that the World Church of the Creator is the only pro-White organization of which I am a member so that my energies may not be divided; that I will remain knowledgeable of our sacred Creed, particularly of the books, Nature's Eternal Religion and The White Man's Bible; that I will always exhibit high character and respect; and lastly, that I will aggressively convert others to our Faith and build my own ministry.

Id.

161. *Id.* (citing Slater v. King Soopers, Inc., 809 F. Supp. 809 (D. Colo. 1992) (finding that the Ku Klux Klan is not a religion under Title VII); Bellamy v. Mason's Stores, Inc., 368 F. Supp. 1025 (E.D. Va. 1973) (same); Augustine v. Anti-Defamation League of B'Nai-B'Rith, 249 N.W.2d 547 (Wis. 1977) (finding that the National Socialist White People's Party is not a religion for purposes of a state anti-discrimination statute)).

162. *Id.*

163. *Id.* (noting that the courts in *Bellamy* and *Slater* provided little discussion as to how they reached their conclusions).

purposes of Title VII.[164] It noted that, unlike the Ku Klux Klan (which considered itself to be a political and fraternal organization, and not a religion), the World Church of the Creator considered Creativity to be a religion.[165] The court concluded that, although Creativity's beliefs could be characterized as "political," they could also function as "religious" beliefs for the plaintiff.[166]

The court concluded its analysis by discussing the role of "morality" and "ethics" in the definition of "religion." In this case, the Defendant had argued that Creativity's beliefs could not be religious because they were immoral and unethical.[167] The court dismissed this argument completely:

> [D]efendant misinterprets the regulation. The regulation does not indicate that Title VII only protects beliefs which defendant, society, the court or some other entity considers moral or ethical in the subjective sense. Indeed, the question of whether I find a belief moral, ethical or otherwise valid in this subjective sense is decidedly not an issue when I am determining whether a belief is "religious." Rather, the EEOC regulation means that "religion" under Title VII includes belief systems which espouse notions of morality and ethics and supply a means from distinguishing right from wrong. Creativity has these characteristics. Creativity teaches that followers should live their lives according to what will best foster the advancement of white people and the denigration of all others. This precept, although simplistic and repugnant to notions of equality that undergird the very non-discrimination statute at issue, is a means for determining right from wrong. Thus, defendant's argument must be rejected.[168]

The court's analysis is notable on several counts. First, the court made a concerted effort to follow the implications of *Seeger* and *Welsh* to their logical ends. It paid close attention to the group's own characterization of Creativity as a religion and considered the possibility that apparently "political" beliefs might also be "religious." In so doing, the court also gave some impression of *its* view of religion. It explicitly stated that the category of "religion" is (or should be) "content neutral," so to speak. Thus, no belief system should be so repulsive to judicial notions of morality as to automatically disqualify itself from the ranks of the "religious." Although the potential contents of "religions" must, then, be limitless, the court espoused a clear view of the *function* of religions. Apparently, "religions" are "belief systems which espouse notions of morality and ethics and supply a means from distinguishing right from wrong."[169] Because Creativity provided the requisite means of distinguishing right from wrong (however repugnant that means might be), it qualified as a religion.

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164. *Id.* (citing EEOC Dec. No. 79-06 (Oct. 6, 1978)).
165. *Id.* at 1023.
166. *Id.*
167. *Id.*
168. *Id.* (internal citations omitted).
169. *Id.*

B. Sincerity and Conflict

Having heeded the warning of *Fowler*, courts often gloss over the direct issue of whether a belief system is "religious." When confronted with a problematic case, they are more likely to engage in an analysis of the believer's "sincerity" or an analysis of whether his or her belief actually "conflicts" with an employment requirement. Although such analyses do not define "religion" directly, they do provide hints of the definition of "religion" with which the courts are operating.

1. Hussein v. The Waldorf-Astoria.—In *Hussein*, the U.S. District Court for the Southern District of New York confronted a claim of employment discrimination which it found to be less than credible.[170] The plaintiff, a Muslim male, worked as a "roll call" banquet waiter for various hotels.[171] He was not a full-time employee of any single hotel. Instead, he was employed when a hotel required extra staff for a particular event. He belonged to the Hotel, Restaurant and Club Employees and Bartenders Union. According to the terms of a collective bargaining agreement, the hotels were obligated to accept the particular waiters assigned by the union unless the hotel had provided written notice to the union barring or suspending a particular waiter for misconduct.[172] Over the course of his years of membership in the union, at least ten hotels had written letters to the union "barring" the plaintiff from working at their banquets for misconduct such as insubordination, rudeness, and physical altercations. The plaintiff also had filed many complaints against his union and various hotels where he had worked.[173]

After returning from a suspension imposed by the union, the plaintiff accepted an assignment at the Waldorf Hotel. At that assignment, he got into an argument because he refused to wear a bow tie as required.[174] The union then provided the plaintiff with a written summary of the Waldorf's dress and appearance requirements, which included a rule that men were not allowed to have any facial hair, except for a neatly-trimmed mustache. Two months later, the plaintiff reported unshaven for an assignment at the Waldorf. He had not shaved for two to five days.[175] A Waldorf representative asked him about his beard, and he replied that it was a "part of my religion."[176] Notably, the plaintiff had never informed anyone at the Waldorf about his religion. The Waldorf would not let him work with a beard. It refused to accommodate his "religion" because it doubted the sincerity of the plaintiff's beliefs, feared that allowing him to wear facial hair would hurt the hotel's reputation, and worried that exempting

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170. Hussein v. The Waldorf-Astoria, 134 F. Supp. 2d 591 (S.D.N.Y. 2001).

171. *Id.* at 593.

172. *Id.*

173. *Id.*

174. *Id.* at 593-94.

175. *Id.*

176. *Id.*

him from the appearance requirements would set a bad precedent for dealing with other roll call waiters. No more than three months later, the plaintiff shaved his beard and continued to remain clean-shaven.[177]

The plaintiff brought suit, alleging that the Waldorf had violated Title VII by failing to accommodate his religious practice of wearing a beard.[178] The court granted summary judgment for the Waldorf, finding that the plaintiff had failed to state a prima facie case of religious discrimination under Title VII.[179] To establish a prima facie case of religious discrimination, the plaintiff must show that (1) he had a bona fide religious belief that conflicted with an employment requirement; (2) he informed the employer of this belief; and (3) he was disciplined for failure to comply with the conflicting employment requirement.[180]

The court first considered whether the plaintiff had established that he had a "bona fide" religious belief that conflicted with an employment requirement. In considering the sincerity of the plaintiff's claim that his religion required him to wear a beard, the court paid little credence to the plaintiff's assertion that it was, in fact, a requirement of his religion.[181] Instead, it focused on the plaintiff's previous behavior. It noted that, until the night in question, the plaintiff had never worn a beard to work at the Waldorf, despite the fact that he had worked there for fourteen years. The court stated: "[The plaintiff] has made no effort to explain why, if his religion prevented him from shaving, he had never worn a beard before. He does not contend, for example, that he had just converted to his religion."[182] The court also found that the plaintiff's sincerity was undercut by the fact that he shaved his beard within three months of the incident.[183] Ultimately, the court concluded that the plaintiff had simply used religion as an "excuse" when he showed up for work unshaven.[184] In granting summary judgment for the Waldorf, the court also noted that the plaintiff had never informed the hotel of his religion and that the Waldorf had acted on a good faith belief that his "religious" claim was not sincere.[185]

The court's sincerity analysis reveals some notions about its conception of religion. First, the court collapsed the analysis of whether a religious belief is "bona fide" into an analysis of whether it is "sincere." The distinction between the two is fine, but a "bona fide religious belief" need not be the same as a "sincere religious belief." The category of "bona fide" seems to refer to the "religious" character of the belief, while the sincerity analysis seems to focus more on whether the person "really" believes it. By making the two co-extensive, the court here operated on the assumption that, to be religious, beliefs

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177. *Id.*
178. *Id.*
179. *Id.* at 599.
180. *Id.* at 596 (citing Philbrook v. Ansonia Bd. of Educ., 757 F.2d 476, 481 (2d Cir. 1985)).
181. *Id.*
182. *Id.*
183. *Id.* at 596-97.
184. *Id.* at 597.
185. *Id.* at 597-98.

must also be "sincere." The court's citation of an opinion dismissing another of Hussein's claims of religious discrimination is telling: "Title VII does not require the accommodation of personal preferences, even if wrapped in religious garb."[186] Thus, even seemingly "religious" beliefs do not qualify as "religious" if they are not "sincere."

The court also gave some guidance about how to identify "sincere religious beliefs." In analyzing the plaintiff's prior behavior, the court suggested that religious beliefs are the type of beliefs that cause believers to engage in behaviors consistent with those beliefs. Thus, if the plaintiff "really" believed that wearing a beard was part of his religion, he would surely have worn a beard at some point in his life prior to the night in question. At the very least, he would not have shaved off his beard a mere three months after claiming that it was "necessary" to his religion.

So conceived, religions are basically sets of "beliefs" that cause adherents to engage in certain required "behaviors." Moreover, truly "religious" people are those who act in accordance with their purported beliefs. The plaintiff in *Hussein* suffered from more credibility problems than most, and the court was probably correct in deciding that his claim was not bona fide. However, its analysis is instructive for its view of religion.

2. EEOC v. Unión Independiente de la Autoridad de Acueductos y Alcantarillados.—In *Unión Independiente*, the U.S. Court of Appeals for the First Circuit approached its sincerity analysis in a similar fashion.[187] The plaintiff, a Seventh-Day Adventist, first applied for temporary employment with the defendant employer. When he applied, he did not indicate his religion. Later, he accepted a permanent position.[188] As a condition of this employment, he was obliged to join a union and pay union dues.

According to the union, he did not indicate that he was categorically opposed to union membership at that time. Instead, he voiced his objection to Saturday meetings, joining demonstrations or strikes, taking the union's loyalty oath, and paying union dues. The union attempted to accommodate him, offering to exempt him from Saturday meetings and public strikes or picketing, to paraphrase its loyalty oath to an affirmation, and to transfer his union dues to a nonprofit organization.[189] Only when he rejected these accommodations did he assert a categorical objection to union membership. By way of contrast, the employee maintained that he had opposed union membership all along.[190]

When the employee refused to join, the union instituted disciplinary proceedings against him. Ultimately, it recommended that the employer suspend him from employment. After unsuccessful appeals, he was terminated for failing

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186. *Id.* at 597 (quoting Hussein v. Hotel Employees & Rest. Union, Local 6, 108 F. Supp. 2d 360, 370 (S.D.N.Y. 2000)).

187. EEOC v. Unión Independiente de la Autoridad de Acueductos y Alcantarillados, 279 F.3d 49 (1st Cir. 2002).

188. *Id.* at 51.

189. *Id.* at 52.

190. *Id.*

to comply with the union membership requirement.[191] The EEOC filed suit on his behalf, alleging that the union had violated Title VII by failing to provide a reasonable accommodation to the employee's religious beliefs and causing the employer to terminate him.[192] The district court granted summary judgment for the employee. The union appealed, arguing that genuine issues of disputed fact remained with respect to various elements of the employee's prima facie case. In particular, it argued that a question of fact remained as to whether the employee's opposition to union membership was the product of a "bona fide religious belief."[193]

The court found the grant of summary judgment to be erroneous.[194] First, the court noted that the "religious" nature of the employee's professed belief could not be disputed because it stemmed from the established tenets of the Seventh-Day Adventist faith. However, the court did engage in an analysis of whether his beliefs were "truly held."[195] Construing the facts in the light most favorable to the employer, the court found that a jury might conclude that the employee's beliefs were not sincere.

In support of this conclusion, it pointed to evidence of various behaviors that seemed to be at odds with his professed religious beliefs: the employee had lied on his employment application; he was divorced; he had taken an oath before a notary on one occasion; and he worked five days a week (as opposed to the six "required" by his faith).[196] The court also noted that the union's evidence suggested that:

> [T]he alleged conflict between [the employee's] beliefs and union membership was a moving target: at first, [he] objected only to certain membership requirements, and he only voiced his opposition to any form of union membership after [the union] agreed to accommodate him with respect to each practice he had identified earlier.[197]

The court remanded the case for trial, noting that "assessing the bona fides of an employee's religious belief is a delicate business."[198]

In making its analysis, the court evinces a view of religion similar to that found in *Hussein*. It looked to the employee's behavior to determine whether his beliefs were "really" religious. It concluded that a jury might conclude that the employee was not "really" opposed to union membership because he had engaged in some acts contrary to his professed faith, such as getting a divorce. As in *Hussein*, "religion" is a set of beliefs which compels certain behaviors and "religious" people can be identified by comparing their actions with their

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191. *Id.*
192. *Id.*
193. *Id.* at 55.
194. *Id.* at 57.
195. *Id.* at 56.
196. *Id.* at 56-57.
197. *Id.* at 57.
198. *Id.*

purported beliefs.

3. Tiano v. Dillard Department Stores, Inc.—Courts also hint at their view of religion when determining whether an employee's religious belief actually "conflicts" with an employment requirement. In *Tiano*, the U.S. Court of Appeals for the Ninth Circuit found that an employer had not violated Title VII when it denied an employee's request for unpaid leave to go on a pilgrimage.[199] The employee, a devout Roman Catholic, worked as a salesperson at a department store. Although the store allowed employees to take unpaid leave at the discretion of the management, it also had a policy which forbade employees from taking leave between October and December, which was the store's busiest season.[200]

The employee learned of a pilgrimage to Medjugorje, Yugoslavia, which would take place between October 17 and October 26. Many people have reported seeing visions of the Virgin Mary at Medjugorje. The employee testified that, after learning of this pilgrimage, she had a "calling from God" to attend the pilgrimage. When asked if she could have taken this pilgrimage at a different time, she said, "No."[201] She requested unpaid leave to go on the October pilgrimage. Her supervisor denied this request. She appealed to the Operations Manager, explaining that she was taking the trip for religious reasons. He also denied her request, citing the no-leave policy.[202] She appealed again, this time to the Store Manager. He denied her request. Although he allowed her to apply to transfer to another store, he told her that she would no longer have a job at his store when she returned from the pilgrimage. She completed the transfer papers and left for the pilgrimage soon thereafter.[203]

When the employee returned from the pilgrimage, she went to her old place of employment to inquire about her status. The Operations Manager told her that she was no longer employed by the store because she had resigned voluntarily. Ultimately, the employee brought suit, alleging that the department store had violated Title VII by terminating her because of her pilgrimage.[204]

The court held that the employee could not establish that she had a "bona fide religious belief" that conflicted with an employment requirement because she had not proved that her religious belief included a "temporal mandate."[205] Reviewing the evidence, the court concluded: "[t]he evidence shows only a bona fide religious belief that she needed to go to Medjugorje at some time; she failed to prove the temporal mandate."[206] It found that the employee's desire to take the pilgrimage at this particular time was merely a "personal preference." Its assessment of her "calling" is rather astonishing and worth quoting at length:

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199. Tiano v. Dillard Dep't Stores, Inc., 139 F.3d 679, 680 (9th Cir. 1998).

200. *Id.*

201. *Id.*

202. *Id.* at 680-81.

203. *Id.* at 681.

204. *Id.*

205. *Id.* at 682.

206. *Id.*

> The only evidence offered by [the plaintiff] to prove that the temporal mandate was part of her calling was her testimony. She directly addressed the question only once: "I felt I was called to go . . . . I felt that from deep in my heart that I was called. *I had to be there at that time.* I had to go." She offered no corroborating evidence to support the claim that she had to attend the pilgrimage between October 17 and 26. For example, she did not testify that the visions of the Virgin Mary were expected to be more intense during that period. Nor did she suggest that the Catholic Church advocated her attendance at that particular pilgrimage. In short, her lone unilateral statement that she "had to be there at that time" was her only evidence.[207]

The court also focused on evidence that it found to be contradictory to the plaintiff's claim that the temporal mandate was part of her bona fide religious belief. First, it noted with suspicion the fact that she had not filed her complaint with the EEOC until after she learned that her ticket for the pilgrimage was not refundable.[208] The court also gave weight to the testimony of a friend who had gone on the pilgrimage with the plaintiff. This friend testified that they had decided to go on this particular pilgrimage after talking about it and deciding that it would be interesting. She also testified that there was no "specific reason" for the plaintiff's desire to go on this particular pilgrimage.[209] The court concluded: "Thus, [the friend's] testimony suggests that the time of the trip was a personal preference, not part of a bona fide religious belief. Both women 'talked about it' and 'thought that it would be interesting to go on'—hardly a religious calling."[210] Having concluded that the employee's religious belief did not include a temporal mandate, the court determined that her religious belief did not "conflict" with an employment requirement. Thus, she could not make out a prima facie case of religious discrimination under Title VII.[211]

The court's analysis is notable for several reasons. First, it expands upon the notion that "religions" basically consist of "beliefs" which result in actions. Starting with the notion that a person may be *required* by a particular religious belief to engage in certain actions, the court went on to suggest that the contents of these religious beliefs and actions are highly specific—and discernible by the court. Moreover, the court put the burden on the plaintiff to *prove* that her calling included a temporal mandate. This at the very least suggests that the court thought that it might be *possible* for the plaintiff to prove such a thing, which is an interesting notion in and of itself. Such a notion presumes that religious systems of thought are rational and capable of conforming to the "proof" standards of the courtroom. In addition, the court emphasized the notion that "real" religious beliefs can be identified by examining the believer's

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207. *Id.*
208. *Id.*
209. *Id.*
210. *Id.* at 682-83.
211. *Id.* at 683.

conduct: Because the believer acted in a way that the court perceived to be incompatible with her professed belief, the court concluded that her belief in a temporal mandate was not "bona fide."

C. Conclusions About the Definition of Religion Used in Employment Discrimination Cases

As the case discussions above demonstrate, the seemingly simple category of "religion" turns out to be problematic. While most courts are unified in recognizing "traditional" churches (and organizations that bear some resemblance to "traditional" churches) as examples of the "religion" protected by Title VII,[212] they struggle mightily to cope with less traditional belief systems. An analysis of these attempts has revealed several themes in the way courts conceive of "religion." First, a "religion" is, first and foremost, a belief system. Second, "religious" belief systems address a discrete set of subjects. Third, "religious" beliefs cause believers to engage in certain actions. Fourth, "religious" people can be identified by comparing their beliefs to their actions. If the two conflict too greatly, courts will find that a supposedly "religious" belief is, in fact, not "sincere." Finally, only "sincere" religious beliefs qualify for protection under Title VII. However commonsensical these conclusions seem, it is important to recognize that the courts' conception of religion is not the *only* possibility. In fact, the courts' approach has distinct problems.

IV. PROBLEMATIZING "RELIGION": ANALYSIS AND CRITIQUE

The conception of "religion" which drives much of religious discrimination jurisprudence is problematic. Despite paying constant homage to *Seeger* and *Welsh*, courts do not consistently apply the expansive definition of religion found in those cases. They seem particularly reluctant to follow this expansive mandate when confronted with "non-traditional" religious beliefs. The remainder of this section analyzes and criticizes the manner in which courts define "religion."

A. What Would Seeger *Do?*

A primary problem with the courts' treatment of "religion" is that they do not always apply the definition they purport to apply. As noted above, courts facing religious discrimination cases under Title VII almost universally invoke *Seeger* and *Welsh* when setting out the definition of "religion."[213] Nonetheless, their application of the *Seeger* and *Welsh* formulation often breaks down.

Courts are reluctant to follow the radical implications of the *Seeger* mandate that the appropriate inquiry is "whether a given belief that is sincere and meaningful occupies a place in the life of its possessor parallel to that filled by

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212. *See* cases cited *supra* note 125.

213. *See supra* note 123 and accompanying text.

the orthodox belief in God."[214] For example, the court in *Brown v. Pena* did not even consider whether the plaintiff's belief in the powers of cat food might occupy a place in his life parallel to that filled by the orthodox belief in God.[215] Likewise, the court in *Slater v. King Soopers, Inc.* seemed reticent to consider the possibility that an ideology so avowedly political and offensive might be "parallel" to a more traditional belief in God.[216]

Similarly, courts do not often follow the lead of *Welsh* and look beyond a believer's characterization of his belief system as "nonreligious."[217] Thus, the court in *Fraser v. New York City Board of Education* concluded that the plaintiff's Hebrew Israelite beliefs were not "religious," despite the fact that his belief system bore many of the hallmarks of a traditional religion.[218] It is not hard to imagine that the *Welsh* court might have found the *Fraser* plaintiff to have "religious" beliefs.

At some level, it is understandable *why* courts do not apply the definition of *Seeger* and *Welsh* consistently. Applied literally, this formulation would open up the ample protections of Title VII to a *vast* array of belief systems that have not previously been considered "religious." On its face, *any* belief system might occupy a place "parallel" to an orthodox belief in God—even a belief in the curative powers of cat food. Indeed, *every* person might be conceived of as having a "religion."[219] If this is the case, Title VII would impose on employers a duty to accommodate the "religions" and "religious practices" of *every single employee*.[220] Such a duty would strike straight to the heart of the traditional model of "at-will" employment, whereby employers may terminate (or refuse to hire) employees for any reason or no reason at all (so long as the reason is not illegal).[221]

The problem with this approach is that courts are most likely to deviate from *Seeger* and *Welsh* when confronted with a "non-traditional" religion. Thus, members of traditional churches are considered presumptively religious and almost automatically receive the protections of Title VII. Adherents of less familiar belief systems—who might seem to need the protection of Title VII the most—are subjected to a more searching analysis. Although courts do not often discount the religiosity of belief systems, "non-traditional" systems are more

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214. United States v. Seeger, 380 U.S. 163, 166 (1965).

215. Brown v. Pena, 441 F. Supp. 1382, 1384-85 (S.D. Fla. 1977).

216. Slater v. King Soopers, Inc., 809 F. Supp. 809, 810 (D. Colo. 1992).

217. Welsh v. United States, 398 U.S. 333, 341 (1970).

218. Fraser v. New York City Bd. of Educ., No. 96 Civ. 0625 (SHS), 1998 U.S. Dist. LEXIS 1338, at *16 (S.D.N.Y. Feb. 10, 1998).

219. James A. Sonne, *The Perils of Universal Accommodation: The Workplace Religious Freedom Act of 2003 and the Affirmative Action of 147,096,000 Souls*, 79 NOTRE DAME L. REV. 1023, 1024 (2004).

220. *Id.*

221. SAMUEL ESTREICHER & MICHAEL C. HARPER, CASES AND MATERIALS ON EMPLOYMENT DISCRIMINATION AND EMPLOYMENT LAW 742 (2d ed. 2004).

likely to be excluded.[222] Such a system of analysis hardly seems to further the antidiscrimination policies of Title VII.

B. The Dark Side of Seeger *and* Welsh

While courts' deviation from *Seeger* and *Welsh* leads to problems, their rigid adherence to this definition of "religion" also proves problematic. *Seeger* and *Welsh* defined "religion" almost exclusively in terms of "belief."[223] Because those cases focused on a conscientious objector statute, they were looking for evidence of a very specific "belief"—namely, a belief that war is wrong. For purposes of the conscientious objector statute, the "belief" part of religion dominated. Courts mimic this focus on "belief" in religious discrimination cases brought under Title VII.

Such an approach to "religion" is deeply problematic. First, by focusing on "belief" to the exclusion of all else, courts leave themselves with no principled way to distinguish between "religion" and other "belief systems." When courts encounter a belief system which does not seem to be "religious enough" to warrant protection, they have a choice: they may follow the apparent implications of their chosen definition of religion and extend protection to *all* beliefs, or they may find some other way to exclude the believer from protection. Without more guidance, courts reach inconsistent results. For example, one court might find that a white supremacist ideology fits the strictures of *Seeger* and *Welsh*, while another might conclude that it is *not* the kind of belief system Title VII was intended to protect. Any definition that leads courts to reach inconsistent results is problematic.

Second, focusing on belief may cause courts to deny protection to people and practices which are legitimately "religious." Following *Seeger* and *Welsh*, the courts are very concerned that believers' beliefs be "sincere." As discussed above, courts will often determine whether beliefs are "sincere" by comparing a would-be believer's actions to his or her purported beliefs.[224] Under such a method of analysis, a court will almost *always* be able to find a way to deny a plaintiff the protection of Title VII. One hardly need be a religious scholar to recognize that apparently "religious" people act in manners contrary to their professed beliefs *all the time*. Moreover, such deviation does not necessarily remove one from the category of "religious." If deviation from a professed set of beliefs disqualifies a person from the category of "religion," very few people will be protected by Title VII. Although the intent of Congress in including religion in Title VII is unclear,[225] it hardly seems likely that Congress intended to protect only those who unfailingly behaved in accordance with a set of

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222. *See* Lori G. Beaman, *The Courts and the Definition of Religion: Preserving the Status Quo Through Exclusion*, *in* DEFINING RELIGION: INVESTIGATING THE BOUNDARIES BETWEEN THE SACRED AND THE SECULAR 203 (Arthur L. Greil & David G. Bromley eds., 2003).

223. *See supra* Part II.A.

224. *See supra* Part III.B.

225. *See supra* text accompanying notes 47-49.

carefully-prescribed beliefs.

An analysis of the cases shows that courts do not routinely apply such a stringent standard to Title VII plaintiffs. In fact, courts are most likely to resort to this "sincerity" analysis when confronted with someone who seems obviously to be fabricating his or her claim (as in *Hussein v. The Waldorf Astoria*)[226] or with someone who professes a rather incredible belief (as the court viewed the plaintiff's claim in *Tiano v. Dillard Department Stores, Inc.*).[227] The problem with this approach is that it seems to favor majoritarian religions and work to the disadvantage of more "non-traditional" religions, again in apparent conflict with the antidiscrimination principles of Title VII.

The disconnect between professed belief and behavior has led many scholars of religion to doubt the primacy of "belief" in the phenomenon of religion. Some scholars (following in the footsteps of French sociologist Emile Durkheim) focus on the primacy of the social and communal in religion.[228] Others (following Mircea Eliade) focus on a sense of "the sacred" as the hallmark of religion.[229] Still others emphasize ritual practice.[230] Although none of these approaches is necessarily "correct," it is worth noting that a focus on community or ritual might lead courts to identify "religions" in a manner more consistent with the policies of Title VII.

Finally, this belief-centered definition may run afoul of the Constitution. As the U.S. Supreme Court has noted, it is tempting to make the analysis of the "sincerity" of a plaintiff turn on the factfinder's own idea of what a religion should be.[231] If courts fall prey to this temptation, they risk "establishing" a religion in contravention of the Establishment Clause of the First Amendment.[232] That is, if courts think that religions "should" consist of beliefs which result in specific actions, they may end up favoring *some* "religions" over others.

CONCLUSION: A RECOMMENDATION FOR THE FUTURE

The courts' approach to "religion" in Title VII cases seems to be deeply flawed. What, then, are courts to do? At some level, their hands are tied by the EEOC's adoption of the formulations of *Seeger* and *Welsh*. Nonetheless, these definitions rest on *statutory*—not *constitutional*—grounds. Thus, there is no theoretical bar to tweaking the definition of "religion" to the Title VII context.

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226. *See* discussion *supra* Part III.B.1.

227. *See* discussion *supra* Part III.B.3.

228. For an overview of Durkheim's view of religion, see DANIEL L. PALS, SEVEN THEORIES OF RELIGION 88-123 (1996).

229. For an overview of Eliade's view of religion, see *id.* at 158-97.

230. For a discussion of the role of ritual in various definitions of religion, see Jonathan Z. Smith, *Religion, Religions, Religious*, *in* CRITICAL TERMS FOR RELIGIOUS STUDIES 270-71 (Mark C. Taylor ed., 1998). For a discussion of Victor Turner's emphasis on ritual, see WALTER H. CAPPS, RELIGIOUS STUDIES: THE MAKING OF A DISCIPLINE 196-97 (1995).

231. Philbrook v. Ansonia Bd. of Educ., 757 F.2d 476, 482 (2d Cir. 1985).

232. *See supra* text accompanying notes 116-20.

Ultimately, courts will be hard-pressed to create another definition of "religion" without more guidance from Congress regarding the purposes served by including religion within the protective reach of Title VII. Until Congress weighs in on this issue, courts would do well to approach religious discrimination suits with caution. Instead of slavishly following *Seeger*, *Welsh*, or any other formulation of "religion," courts should begin their analysis with a close consideration of the antidiscrimination policies of Title VII. By thinking in fresh ways about religion, courts might come to better resolutions of religious discrimination cases. At the very least, they will open the door to a broader societal discussion of the degree of protection that should be afforded to religion in the workplace.

THE DORMANT COMMERCE CLAUSE: ECONOMIC DEVELOPMENT IN THE WAKE OF *CUNO*

MARY F. WYMAN*

INTRODUCTION

Economic development has been in the forefront of the news for many years. As industries have folded, states have scrambled to bring in new businesses or help other businesses within their state expand so that jobs will not be lost. At times, states are in direct competition with one another as each tries to put together the best incentive package to attract jobs. To attract prospective businesses, such packages might include incentives such as tax credits, refunds, or abatements from a variety of state taxes; direct subsidies which can take the form of cash and land grants; low-interest loans and financing; or preferential government purchasing practices.[1] These "bidding wars" between the states have become commonplace.[2]

The use of state tax policy to shape a state's economic development is not new. In the early development of our nation, taxes were unsuccessfully used as obstacles to prevent out-of-state businesses from competing with local companies.[3] However, in recent years, tax incentives have been used to influence businesses to decide where to locate.[4] These tax incentives have recently been challenged as discriminating against interstate commerce by a group of citizens and businesses in Ohio that were displaced when DaimlerChrysler received incentives to construct a new Jeep plant in Toledo.[5]

The Commerce Clause has been interpreted not only to confer power on Congress to regulate commerce, but also to limit the states' power to interfere

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1. Matthew Schaefer, *State Investment Attraction Subsidy Wars Resulting from a Prisoner's Dilemma: The Inadequacy of State Constitutional Solutions and the Appropriateness of a Federal Legislative Response*, 28 N.M. L. REV. 303, 306-07 (1998).

2. Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 380 (1996).

3. *See* Guy v. Baltimore, 100 U.S. 434, 443-44 (1879) (holding unconstitutional a statute that required vessels to pay wharfage fees if transporting products not from the state of Maryland); Welton v. Missouri, 91 U.S. 275, 282 (1875) (holding unconstitutional a statute that required itinerant salesmen to purchase a license if selling goods produced out-of-state); Brown v. Maryland, 25 U.S. 419, 449 (1827) (holding unconstitutional a statute that required importers of out-of-state articles to purchase a license before being permitted to sell such articles).

4. Walter Hellerstein, *Commerce Clause Restraints on State Tax Incentives*, 82 MINN. L. REV. 413, 413 (1997); William J. Barrett VII, Note, *Problems with State Aid to New or Expanding Businesses*, 58 S. CAL. L. REV. 1019, 1023-24 (1985).

5. *Court Ruling Jeopardizes Ohio Projects*, TOL. BUS. J., Oct. 1, 2004, at 1.

with commerce.[6] However, the Supreme Court indicated in *Boston Stock Exchange v. State Tax Commission*[7] that the Commerce Clause "does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry."[8] Nor does it prevent competition between the states for a share of interstate commerce as long as "no state . . . discriminatorily tax[es] the products manufactured or the business operations performed in any other State."[9] The father of our Constitution, James Madison, wrote:

> [T]he Commerce Clause "grew out of the abuse of the power by the importing States in taxing the non-importing, and was intended as a negative and preventive provision against injustice among the States themselves, rather than as a power to be used for the positive purposes of the General Government."[10]

The Supreme Court has not yet weighed in on the constitutionality of economic development incentive packages, though its prior decisions related to tax incentives provide some guidance. "The Supreme Court has repeatedly invoked the Commerce Clause to condemn state tax measures that protect in-state businesses from out-of-state rivals"[11] or "that impose special burdens that deter out-of-state businesses from competing for business in the state."[12] Nevertheless, in reviewing the Court's prior precedent, "it sometimes is difficult to distinguish a tax that legitimately 'encourag[es] the growth and development of intrastate commerce and industry' from a tax that unconstitutionally discriminates against interstate commerce."[13]

Even though the Court has not addressed a challenge assessing whether "a state tax provision's primary purpose or effect is to attract business to locate or expand in the state,"[14] the United States Court of Appeals for the Sixth Circuit was given that opportunity when it held in *Cuno v. DaimlerChrysler, Inc.* that the investment tax credit granted by Ohio to DaimlerChrysler to build its new Jeep

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6. Philip M. Tatarowicz & Rebecca F. Mims-Velarde, *An Analytical Approach to State Tax Discrimination Under the Commerce Clause*, 39 VAND. L. REV. 879, 881 (1986).

7. 429 U.S. 318 (1977).

8. *Id.* at 336.

9. *Id.* at 336-37.

10. West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 193 n.9 (1994) (quoting 3 M. FARRAND, RECORDS OF THE FEDERAL CONVENTION OF 1787, at 478 (1911)).

11. Enrich, *supra* note 2, at 381 (citing *West Lynn Creamery*, 512 U.S. at 188; Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 276 (1984); Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336 (1977)).

12. *Id.* (citing New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 280 (1988); American Trucking Ass'ns v. Scheiner, 483 U.S. 266, 296-97 (1987); Armco Inc. v. Hardesty, 467 U.S. 638, 642-44 (1984)).

13. Tatarowicz & Mims-Velarde, *supra* note 6, at 885 (quoting Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336 (1977)).

14. Enrich, *supra* note 2, at 381.

plant in Toledo violated the Commerce Clause.[15]

Additionally, there has been considerable debate over the effectiveness and wisdom of state tax and business incentives.[16] Some scholars argue that the use of state tax incentives creates a "prisoners' dilemma"[17] or "race to the bottom"[18] resulting in an adverse fiscal impact.[19] Others cast a skeptical look at those arguments and contend that "competition among states for business may actually facilitate the objective created by the Commerce Clause of achieving economic integration for the benefit of the nation as a whole."[20] The purpose of this Note is not to enter this debate but to analyze various tax incentives employed by the states to induce businesses to locate or expand within their borders. This analysis evaluates the reasoning employed by the Sixth Circuit in its recent decision of *Cuno v. DaimlerChrysler*.[21]

Part I of this Note briefly examines previous United States Supreme Court decisions regarding dormant Commerce Clause issues. Part II specifically analyzes the Ohio economic development incentive package recently provided by the City of Toledo to DaimlerChrysler to construct a new vehicle-assembly plant. The Sixth Circuit concluded that a portion of the package, specifically, the "investment tax credit [could] not be upheld under the Commerce Clause of the United States Constitution."[22] The personal property tax exemption, however, was upheld.[23] This decision places the states in the Sixth Circuit at a much greater disadvantage in attracting business to their states. Rather than removing barriers to interstate commerce, it seems that the court has instead put them in place. In Part III, this Note compares the *Cuno* decision of the Sixth Circuit to a Michigan Supreme Court decision which upheld the validity of a capital acquisition deduction that was, in relevant part, identical to the Ohio investment

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15. Cuno v. DaimlerChrysler, Inc., 386 F.3d 738, 746 (6th Cir. 2004), *cert. granted*, 73 U.S.L.W. 3751 (U.S. Sept. 27, 2005) (No. 04-1704).

16. Hellerstein, *supra* note 4, at 413.

17. *See generally* Schaefer, *supra* note 1, at 342 (concluding "[e]ach state would be better off if its ability to grant investment attraction subsidies was limited[,]" though no state "wants to unilaterally disarm" and incur the result).

18. Enrich, *supra* note 2, at 380. *But cf.* Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom" Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. REV. 1210, 1236-42 (1992).

19. James R. Rogers, *The Effectiveness and Constitutionality of State Tax Incentive Policies for Locating Business: A Simple Game Theoretic Analysis*, 53 TAX LAW. 431, 431 (2000).

20. Clayton P. Gillette, *Business Incentives, Interstate Competition, and the Commerce Clause*, 82 MINN. L. REV. 447, 448 (1997); *see also* Daniel P. Petrov, Note, *Prisoners No More: State Investment Relocation Incentives and the Prisoners' Dilemma*, 33 CASE W. RES. J. INT'L L. 71, 104-10 (2001) (contending that the prisoners' dilemma must be adjusted for complexities and justifications for relocation incentives).

21. 386 F.3d 738, 742-48 (6th Cir. 2004), *cert. granted*, 73 U.S.L.W. 3751 (U.S. Sept. 27, 2005) (No. 04-1704).

22. *Id.* at 746.

23. *Id.* at 748.

tax credit.

Part IV of this Note evaluates how other economic development tax incentives, including subsidies, fare based on the broad interpretation by the Sixth Circuit of tax incentives that burden interstate commerce. Notwithstanding the broad interpretation by the Sixth Circuit, many of these incentives should still pass constitutional scrutiny. Finally, the conclusion of this Note addresses which state tax incentives, if challenged, should be upheld and why.

I. DORMANT COMMERCE CLAUSE CASES

The Commerce Clause of the United States Constitution provides in part that "Congress shall have Power . . . [t]o regulate [c]ommerce . . . among the several States . . . ."[24] Thus, the Constitution explicitly gives Congress the power to regulate commerce between states.

Even though the Commerce Clause is phrased as a grant of regulatory power, Justice Scalia noted in *New Energy Co. of Indiana v. Limbach*[25] that it has long been accepted that the Commerce Clause also directly limits the power of the States to discriminate against interstate commerce and "[t]hus, state statutes that clearly discriminate against interstate commerce are routinely struck down."[26] This "negative" aspect is also referred to as the "dormant" Commerce Clause.[27] "The policy behind this doctrine is simple: to prevent the states—in the absence of congressional action—from creating insurmountable barriers among themselves, thereby eradicating the unity that the Framers of our Constitution strove to create."[28] Justice Cardozo noted that "[the Constitution] was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division."[29] Following is a summary of recent cases decided by the Court in which state taxes raised a dormant Commerce Clause issue.

A. Boston Stock Exchange v. State Tax Commission

In *Boston Stock Exchange v. State Tax Commission*,[30] the Court struck down a New York statute that imposed a higher tax on transfers of stock that occurred outside the state than on transfers which involved a sale within the state.[31] The Court noted that "[t]he obvious effect of the tax [was] to extend a financial advantage to sales on the New York exchanges at the expense of the regional

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24. U.S. CONST. art. I, § 8, cl. 3.

25. 486 U.S. 269 (1988).

26. *Id.* at 274.

27. Tatarowicz & Mims-Velarde, *supra* note 6, at 881-82.

28. Amy M. Petragnani, *The Dormant Commerce Clause: On Its Last Leg*, 57 ALB. L. REV. 1215, 1215 (1994).

29. Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336 n.14 (1977) (quoting Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511, 522-23 (1935)).

30. 429 U.S. 318 (1977).

31. *Id.* at 328 (referencing N.Y. TAX LAW § 270-a (McKinney Supp. 1976)).

exchanges."[32]

B. Maryland v. Louisiana

In *Maryland v. Louisiana*,[33] the Court exercised original jurisdiction in an action by "several States, joined by the United States and a number of pipeline companies, challeng[ing] the constitutionality of Louisiana's 'First-Use Tax' imposed on certain uses of natural gas brought into Louisiana, principally from the Outer Continental Shelf (OCS)."[34] The statute,[35] along with other state statutes,[36] provided a number of exemptions and credits related to the tax. The net effect, for the most part, was that Louisiana consumers of OCS gas were not burdened by the tax, but the tax did apply to gas moving out of state. The Court thus concluded that "the First-Use Tax [was] unconstitutional under the Commerce Clause because it unfairly discriminate[d] against purchasers of gas moving through Louisiana in interstate commerce."[37]

C. Westinghouse Electric Corp. v. Tully

In *Westinghouse Electric Corp. v. Tully*,[38] the New York statute at issue was in response to federal Domestic International Sales Corporation ("DISC") legislation.[39] A state franchise tax provision allowed certain businesses an income tax credit based on the portion of the business's exports shipped from locations within New York.[40] The Court provided detailed examples of how the credit was designed to increase as New York's share of the export activity increased and therefore decreased as the other states' export activity increased.[41] The intended purpose of the credit was to "ensure that New York would not lose its competitive position vis-a-vis other States, since other States were also expected to offer tax benefits to DISCs."[42] The Court concluded that not only did the New York tax scheme provide a positive incentive for increased export activity in New York,[43] but it also penalized increases in DISC's shipping activities in other states and therefore was in violation of the Commerce Clause.[44]

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32. *Id.* at 331.
33. 451 U.S. 725 (1981).
34. *Id.* at 728.
35. LA. REV. STAT. ANN. §§ 47:1301-47:1307 (West Supp. 1981).
36. *Id.* § 47:647.
37. *Maryland v. Louisiana*, 451 U.S. at 760.
38. 466 U.S. 388 (1984).
39. *Id.* at 393 (referencing N.Y. TAX LAW §§ 208-219-a (McKinney Supp. 1983-1984)).
40. *Id.*
41. *Id.* at 401 n.9.
42. *Id.* at 397.
43. *Id.* at 400-01.
44. *Id.* at 407.

D. Bacchus Imports, Ltd. v. Dias

In *Bacchus Imports, Ltd. v. Dias*,[45] Hawaii imposed a twenty percent excise tax on sales of liquor at wholesale. However, an exemption was allowed for fruit wine manufactured in Hawaii and for okolehao, a brandy distilled from the root of a shrub indigenous to Hawaii.[46] The Court noted that "[a] finding that state legislation constitutes 'economic protectionism' may be made on the basis of either discriminatory purpose . . . or discriminatory effect."[47] The Court concluded that the Hawaii liquor tax exemption "violated the Commerce Clause because it had both the purpose and effect of discriminating in favor of local products."[48]

E. New Energy Co. of Indiana v. Limbach

New Energy Co. of Indiana v. Limbach[49] involved an Ohio tax credit designed to encourage the in-state production of ethanol. Ohio allowed a tax credit against the state's motor fuel tax for each gallon of ethanol sold by fuel dealers, but only if the ethanol was produced in Ohio or in a state that granted similar tax advantages to ethanol produced in Ohio.[50] The Court concluded that the provision "explicitly deprive[d] certain products of generally available beneficial tax treatment because they [were] made in certain other States, and thus on its face appear[ed] to violate the cardinal requirement of nondiscrimination."[51]

F. West Lynn Creamery, Inc. v. Healy

In *West Lynn Creamery, Inc. v. Healy*,[52] "a Massachusetts pricing order impose[d] an assessment on all fluid milk sold by dealers to Massachusetts retailers."[53] Approximately two-thirds of that milk was produced out-of-state; however, "the entire assessment . . . [was] distributed to Massachusetts dairy farmers."[54] The state argued that "[b]ecause each component of the program—a local subsidy and a nondiscriminatory tax—[was] valid, the combination of the two [would be] equally valid."[55]

The Court noted that even if both components of the pricing order were valid,

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45. 468 U.S. 263 (1984).
46. *Id.* at 265; *see* HAW. REV. STAT. § 244-4(6), (7) (Supp. 1983).
47. *Bacchus Imports, Ltd.*, 468 U.S. at 270 (citations omitted).
48. *Id.* at 273.
49. 486 U.S. 269 (1988).
50. *Id.* at 272; *see* OHIO REV. CODE ANN. § 5735.145(B) (West 1986).
51. *New Energy Co. of Ind.*, 486 U.S. at 274.
52. 512 U.S. 186 (1994).
53. *Id.* at 188.
54. *Id.*
55. *Id.* at 198.

the pricing statute was nevertheless unconstitutional.[56] Justice Stevens, speaking for the majority, stated that "[a] pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business."[57] Generally, "[t]he existence of major in-state interests adversely affected . . . is a powerful safeguard against legislative abuse."[58] In this case, however, the pricing order was funded principally from taxes on the sale of milk produced in other states. By funding the subsidy in this manner, the Court noted that the state not only assisted local farmers, but also burdened interstate commerce by "violat[ing] the cardinal principle that a State may not 'benefit in-state economic interests by burdening out-of-state competitors.'"[59]

II. Recent Decisions Affecting Economic Development

The Commerce Clause has been cited repeatedly by the Supreme Court to condemn state tax measures that protect in-state businesses from out-of-state rivals[60] or that impose special burdens on out-of-state businesses in order to deter them from competing for business in-state.[61] Even though the Court has not addressed "a challenge [where the] state tax provision's primary purpose or effect is to attract businesses to locate or expand in the state,"[62] the United States Court of Appeals for the Sixth Circuit did address this challenge in *Cuno v. DaimlerChrysler*.[63] However, hopefully the murky waters of the dormant Commerce Clause will become much clearer as the Court has granted certiorari to the *Cuno* appellants.[64]

A. Cuno v. DaimlerChrysler, Inc.

In 1998, DaimlerChrysler, Inc., in exchange for various tax incentives, entered into an agreement with the City of Toledo to construct a new vehicle-assembly plant near the company's existing facility. These incentives included a 100% property tax exemption as well as an investment tax credit of 13.5 % against the state corporate franchise tax for certain qualifying investments. Ohio's investment tax credit grants a taxpayer a nonrefundable

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56. *Id.* at 199.

57. *Id.*

58. *Id.* at 200 (quoting Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 473 n.17 (1981)).

59. *Id.* at 199 (quoting New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 273-74 (1988)).

60. Enrich, *supra* note 2, at 381 (citing *West Lynn Creamery*, 512 U.S. at 188; Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 276 (1984); Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336 (1977)).

61. *Id.* (citing *New Energy Co. of Ind.*, 486 U.S. at 280; Am. Trucking Ass'ns v. Scheiner, 483 U.S. 266, 296-97 (1987); Armco Inc. v. Hardesty, 467 U.S. 638, 642-44 (1984)).

62. *Id.*

63. 386 F.3d 738 (6th Cir. 2004), *cert. granted*, 73 U.S.L.W. 3751 (U.S. Sept. 27, 2005) (No. 04-1704).

64. *Id.*

credit against the state's corporate franchise tax if the taxpayer "purchases new manufacturing machinery and equipment during the qualifying period, provided that the new manufacturing machinery and equipment are installed in [Ohio]."[65] The court of appeals determined this to be in violation of the Commerce Clause.[66] The property tax exemption, however, was upheld.[67]

The parties did not dispute that "the tax provisions at issue [had] a sufficient nexus with the state, [were] fairly apportioned, and [were] related to benefits provided by the state."[68] Likewise, the parties did not dispute that "it [was] legitimate for Ohio to structure its tax system to encourage new intrastate economic activity."[69] The plaintiffs in *Cuno*, however, maintained that even though the investment tax credit at issue was equally available to in-state and out-of-state businesses, the state's investment tax credit "coerc[ed] businesses already subject to the Ohio franchise tax to expand locally rather than out-of-state."[70]

Specifically, the plaintiffs noted that by locating significant new machinery and equipment within the state any corporation doing business within the state of Ohio, and thus paying the state's corporate franchise tax, could reduce its existing tax liability.[71] The corporation, however, would not receive a reduction in its corporate franchise tax liability if a comparable plant and equipment were located elsewhere.[72] The plaintiffs noted that as a result, two businesses similarly situated and each subject to Ohio taxation would be treated differently. Namely, the business that made a choice to expand its presence in Ohio would receive a reduced tax burden, based directly on its new in-state investment, whereas a competitor that invested out-of-state would face a comparatively higher tax burden because it would be ineligible for any credit against its Ohio tax.[73]

The plaintiffs analogized the Ohio investment tax credit to the tax provisions

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65. OHIO REV. CODE ANN. § 5733.33(B)(1) (West 2004). The investment tax credit is generally 7.5 percent "of the excess of the cost of the new manufacturing machinery and equipment purchased during the calendar year for use in a county over the county average new manufacturing machinery and equipment investment for [the] county." *Id.* § 5733.33(C)(1). The rate increases to 13.5 percent of the cost of the new investment if it is purchased for use in specific economically depressed areas. *Id.* § 5733.33(C)(2), (A)(8)-(13).

66. *Cuno*, 386 F.3d at 746.

67. *Id.* at 748.

68. *Id.* at 742; *see also* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (referring to the four concrete concerns identified by the Court that a state tax provision must satisfy in order to pass constitutional muster). Specifically, a tax will be upheld against a Commerce Clause challenge "when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Id.*

69. *Cuno*, 386 F.3d at 742.

70. *Id.* at 743.

71. *Id.*

72. *Id.*

73. *Id.*

considered in *Boston Stock Exchange*, *Maryland v. Louisiana*, and *Westinghouse Electric Corp.*, arguing that Ohio encouraged the development of local business though its "power to tax an in-state operation as a means of 'requiring [other] business operations to be performed in the home State.'"[74] The plaintiffs further contended that the Ohio investment tax credit, like the tax credit in *Maryland v. Louisiana*, encouraged further investment in-state at the expense of development in other states which in turn hindered free trade among the states.[75]

The defendants argued that "the Supreme Court's opinions should be read narrowly to hold that tax incentives, like the Ohio tax credit, are permissible as long as they do not penalize out-of-state economic activity."[76] The defendants cited the theory espoused by Philip Tatarowicz and Rebecca Mims-Velarde who have concluded that "a state tax incentive that focuses exclusively on a taxpayer's in-state activities does not have the sort of negative impact on interstate commerce with which the [C]ommerce [C]lause is concerned."[77] Instead, Tatarowicz and Mims-Velarde suggested that "the key to finding a tax incentive unconstitutionally discriminatory appears to be a reliance by the state tax provision on both a taxpayer's in-state [as well as] out-of-state activities in determining the taxpayer's effective tax rate."[78] The court commented that based on Tatarowicz's and Mims-Velarde's view, "the Commerce Clause is primarily concerned with preventing economic protectionism—that is, regulatory measures designed to benefit local interests by burdening out-of-state commerce."[79]

The court agreed that it was "arguably possible" to fit the Supreme Court cases into the framework suggested by Tatarowicz and Mims-Velarde but determined it "clear" that "the Court itself has not adopted this approach in analyzing dormant Commerce Clause cases."[80] The court cited *Bacchus Imports, Ltd.* and *Westinghouse Electric Corp.* in reaching this conclusion; however, it did not discuss how the cases were analogous. In *Westinghouse*, New York allowed certain businesses an income tax credit based on the portion of the business's exports shipped from New York.[81] In *Bacchus*, Hawaii allowed an exemption from its excise tax on sales of liquor at wholesale for fruit wine manufactured in Hawaii.[82] Both those cases involved the sale of goods and a continuing benefit to in-state economic activity at the expense of out-of state activity, whereas the tax credit at issue in *Cuno* relates not to the sale of goods in interstate commerce but to a one time reduction in franchise taxes for purchases of new machinery and equipment installed in-state.

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74. *Id.* at 745 (quoting Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336 (1977) (internal citations omitted)).

75. *Id.*

76. *Id.*

77. Tatarowicz & Mims-Velarde, *supra* note 6, at 928-29.

78. *Id.* at 929.

79. *Cuno*, 386 F.3d at 745.

80. *Id.*

81. Westinghouse Elec. Corp. v. Tully, 466 U.S. 388, 393 (1984).

82. Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 265 (1984).

The defendants also argued that the investment tax credit was similar to a direct subsidy; however, this argument was rejected by the court even though it agreed that the two would have the same economic effect.[83] The court stated that "the distinction between a subsidy and a tax credit, in the constitutional sense, results from the fact that the tax credit involves state regulation of interstate commerce through its power to tax."[84]

The Supreme Court has provided that "the first step in analyzing any law subject to judicial scrutiny under the negative Commerce Clause is to determine whether it 'regulates evenhandedly with only 'incidental' effects on interstate commerce, or discriminates against interstate commerce.'"[85] Discrimination in the context of interstate commerce "simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter. If a restriction on commerce is discriminatory, it is virtually *per se* invalid."[86]

However, the Supreme Court indicated in *Boston Stock Exchange* that the Commerce Clause "does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry."[87] Nor does it prevent competition between the states for a share of interstate commerce as long as "no State . . . discriminatorily tax[es] the products manufactured or the business operations performed in any other State."[88] Ohio, along with every other state in the nation, has structured its tax system to encourage growth and development. In Ohio, that included an investment tax credit on qualifying purchases of machinery and equipment, yet the Sixth Circuit held that "Ohio's investment tax credit [could not] be upheld under the Commerce Clause of the United States Constitution."[89] Although the court quoted several passages from the previously noted Supreme Court dormant Commerce Clause precedent, it failed to provide an analysis of how *Cuno* was similar to those cases. It simply provided a conclusory statement that Ohio's investment tax credit could not be upheld.[90]

Even though Ohio's investment tax credit was held to violate the dormant Commerce Clause, its personal property tax exemption was upheld.[91] The court distinguished a tax credit from an exemption by explaining that an investment tax credit reduces preexisting income tax liability whereas a personal property exemption does not reduce any preexisting property tax liability but instead "merely allows a taxpayer to avoid tax liability for new personal property put

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83. *Cuno*, 386 F.3d at 746.

84. *Id.*

85. Or. Waste Sys., Inc. v. Envtl. Quality Comm'n of Or., 511 U.S. 93, 99 (1994) (quoting Hughes v. Oklahoma, 441 U.S. 322, 336 (1979)).

86. *Id.*

87. 429 U.S. 318, 336 (1977).

88. *Id.* at 336-37.

89. *Cuno*, 386 F.3d at 746.

90. *Id.*

91. *Id.* at 748.

into first use in conjunction with a qualified new investment."[92] The court went on to state that "the personal property tax exemption is internally consistent because, if universally applied, the new property would escape tax liability irrespective of location."[93] Could not the same be said if the investment tax credit was universally applied?

B. The Other Side of the Coin—Caterpillar, Inc. v. Department of Treasury

The decision reached by the Sixth Circuit in *Cuno* was in direct contradiction to the decision reached by the Michigan Supreme Court in *Caterpillar, Inc. v. Department of Treasury*.[94] In *Caterpillar*, the Michigan court upheld a capital acquisition deduction that, although not identical to the Ohio investment tax credit, was similar in that a taxpayer received a higher deduction as more property was located in-state.[95]

Corporations doing business in Michigan pay taxes to the state pursuant to the Single Business Tax Act ("SBT").[96] Before determining its SBT liability, a taxpayer doing business both within and outside of Michigan must apportion its "tax base" by applying a three-factor apportionment formula.[97] This formula (which also was challenged by *Caterpillar*)[98] consists of "the average of three ratios: (1) Michigan payroll to total payroll, (2) Michigan property to total property, and (3) Michigan sales to total sales."[99] After apportionment, the adjusted tax base is subject to additional adjustments including the capital acquisition deduction.[100]

The capital acquisition deduction, just as its name implies, provides a deduction for the acquisition of capital assets.[101] The deduction for the acquisition cost of real property is one hundred percent of the cost of depreciable real property provided that the property is physically located in Michigan.[102] The deduction for tangible personal property, however, is calculated using a two-factor apportionment formula based on the average of payroll and property located in Michigan compared to total payroll and property located everywhere.[103] Caterpillar claimed that the capital acquisition deduction, for both real and tangible personal property, burdened interstate commerce and thus

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92. *Id.* at 747.
93. *Id.* at 748.
94. Caterpillar, Inc. v. Dep't of Treasury, 488 N.W.2d 182, 194 (Mich. 1992).
95. *Id.*
96. *Id.* at 183.
97. *Id.* at 185.
98. *Id.* at 184; *see also* Trinova Corp. v. Mich. Dep't of Treasury, 498 U.S. 358, 387 (1991) (holding the three-factor apportionment formula as applied to the SBT did not violate the Constitution).
99. *Trinova Corp.*, 498 U.S. at 367-68.
100. *Caterpillar*, 488 N.W.2d at 185-86.
101. *Id.* at 186.
102. *Id.* at 187.
103. *Id.* at 186-87.

violated the Commerce Clause of the Constitution.[104]

A majority of the Michigan Supreme Court concluded that the enactment of the capital acquisition deduction was neither for a discriminatory purpose,[105] nor did the capital acquisition deduction have a discriminatory effect.[106] The court determined the two-factor formula utilizing only payroll and property for the deduction related to the acquisition of tangible personal property was fair, as a company's acquisition of capital is most likely to be located where a company's property and employees are located.[107] Similarly, a deduction of the cost of real property located in Michigan was determined to "reasonably reflect[] capital acquisitions related to Michigan business activity."[108] Both Chief Justice Cavanagh[109] and Justice Brickley[110] dissented, claiming that the deduction related to tangible personal property burdened interstate commerce. Justice Brickley, however, disagreed[111] with Justice Cavanagh who concluded that the deduction for the acquisition of real property located in Michigan also discriminated against interstate commerce.[112] Unlike the court majority, both dissenting judges provided a detailed explanation comparing Michigan's capital acquisition deduction to previous Supreme Court Commerce Clause precedent, yet reached different conclusions.

Both dissenting justices compared the personal property deduction to the tax credit on exports disallowed by the Court in *Westinghouse Electric Corp.*[113] In *Westinghouse*, the credit was designed to increase as New York's share of the export activity increased and to decrease as other states' export activity increased.[114] Justice Brickley noted that there was a clear-cut rule emerging from *Westinghouse*: "Basing a deduction on a change in a subset of a company's in-state activity relative to its total activity is unconstitutional."[115] By basing the personal property acquisition deduction on only two of the factors, payroll and property, rather than the three factors used to calculate the apportioned tax base, the capital acquisition deduction is available on different, less favorable, terms to companies depending on the amount of their interstate activities,[116] resulting in the effect condemned in *Westinghouse Electric Corp.*[117] Justice Brickley, however, went on to state that "a deduction apportioned with the same formula

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104. *Id.* at 183.
105. *Id.* at 192.
106. *Id.* at 194.
107. *Id.* at 190.
108. *Id.* at 191.
109. *Id.* at 207 (Cavanagh, C.J., dissenting).
110. *Id.* at 216 (Brickley, J., dissenting in part).
111. *Id.* at 219.
112. *Id.* at 208 (Cavanagh, C.J., dissenting).
113. *Id.* at 200-01; *id.* at 216-17 (Brickley, J., dissenting in part).
114. Westinghouse Elec. Corp. v. Tully, 466 U.S. 388, 401 n.9 (1984).
115. *Caterpillar*, 488 N.W.2d at 216 (Brickley, J., dissenting in part).
116. *Id.* at 217.
117. *Id.* at 216 n.6.

as multistate activity generally would reflect the change in the entire activity in Michigan . . . [and] would likely be constitutional."[118]

Unlike Justice Brickley, Chief Justice Cavanagh disagreed with the majority and concluded that the capital acquisition deduction for the cost of depreciable real property located in Michigan was unconstitutional.[119] The Chief Justice concluded that the deduction was facially discriminatory because a company that acquired depreciable real property in Michigan received a deduction, but a company that acquired depreciable real property in another state did not.[120] The discriminatory effect was "to afford an especially preferential tax rate to a Michigan-based company that invests in Michigan, as compared to a non-Michigan based company that invests outside Michigan."[121] Justice Brickley, however, determined that there was no discriminatory effect because the tax was fairly apportioned.[122]

C. *Are* Cuno *and* Caterpillar *Distinguishable?*

Both *Cuno v. DaimlerChrysler* and *Caterpillar, Inc. v. Department of Treasury* involve the acquisition of capital assets. Ohio allows a credit against its corporate franchise tax for qualifying investments of machinery and equipment, provided they are installed in Ohio. Michigan allows a deduction, rather than a credit, for the acquisition of the cost of depreciable real property acquired during the year, provided the property is located in Michigan. The net effect is the same: a lower effective in-state tax rate. The Michigan Supreme Court held that this is not in violation of the Commerce Clause, that the statute allowing it is not facially discriminatory, and that there is neither a discriminatory purpose nor discriminatory effect,[123] yet the Sixth Circuit disagreed.[124]

III. Has a Nail been Placed in the Coffin of Economic Development Tax Incentives? Or Just Within the Sixth Circuit?

Referring to the decisions of the Supreme Court in *Boston Stock Exchange*, *Bacchus Imports, Ltd.*, *Westinghouse Electric Corp.*, and *New Energy Co. of Indiana*, Professor Walter Hellerstein suggests that constitutional suspicion surrounding state tax incentives is well justified.[125] Professors Hellerstein and Coenen commented that "[s]tate tax incentives, whether in the form of credits, exemptions, abatements, or other favorable treatment typically possess two

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118. *Id.*

119. *Id.* at 218.

120. *Id.* at 204 (Cavanagh, C.J., dissenting).

121. *Id.*

122. *Id.* at 220-21 (Brickley, J., dissenting in part).

123. *Id.* at 194 (majority opinion).

124. Cuno v. DaimlerChrysler, Inc., 386 F.3d 738, 746 (6th Cir. 2004), *cert. granted*, 73 U.S.L.W. 3751 (U.S. Sept. 27, 2005) (No. 04-1704).

125. Hellerstein, *supra* note 4, at 416.

features that render them suspect under the rule barring taxes that discriminate against interstate commerce."[126] First, they "single out for favorable treatment construction, investments, or other activities that occur within the taxing state."[127] Second, because state tax incentives are "integral components of the state's taxing apparatus," they "are intimately associated with the coercive machinery of the state."[128]

Arguably, a literalistic focus on key passages might suggest that all inducements to encourage new businesses to locate or expand its existing businesses within a state are likely to be unconstitutional.[129] "After all, it is the rare state tax incentive that results in 'tax-neutral decisions' made 'solely on the basis of nontax criteria.'"[130] It thus begs the question: Are all state tax incentives unconstitutional? Instinctively, according to Professor Hellerstein, the answer is no.[131]

The Court itself has stated that the Commerce Clause "does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry."[132] Nor does it prevent competition between the states for a share of interstate commerce as long as "no State . . . discriminatorily tax[es] the products manufactured or the business operations performed in any other State."[133] Moreover, "[i]t is a laudatory goal in the design of a tax system to promote investment that will provide jobs and prosperity to the citizens of the taxing State."[134]

Nonetheless, scholars agree that the Supreme Court lacks a clear vision of principles to guide it when deciding Commerce Clause challenges to state taxes.[135] "The Court itself has recognized its lack of consistency."[136] Justice Scalia has described the Court's decisions from the "so-called 'negative'" Commerce Clause as a "quagmire" that makes no sense.[137] Even so, it seems that

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126. Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789, 793 (1996).

127. *Id.*

128. *Id.* at 794.

129. Hellerstein, *supra* note 4, at 421.

130. *Id.* (quoting Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 331 (1977)).

131. *See id.* at 424.

132. *Boston Stock Exch.*, 429 U.S. at 336.

133. *Id.* at 337.

134. Trinova Corp. v. Mich. Dep't of Treasury, 498 U.S. 358, 385 (1991).

135. Edward A. Zelinsky, *Restoring Politics to the Commerce Clause: The Case for Abandoning the Dormant Commerce Clause Prohibition on Discriminatory Taxation*, 29 OHIO N. U. L. REV. 29, 30 (2002) [hereinafter Zelinsky, *Restoring Politics to the Commerce Clause*]; Ferdinand P. Schoettle, *Big Bucks, Cloudy Thinking: Constitutional Challenges to State Taxes—Illumination from the GATT*, 19 VA. TAX REV. 277, 281 (1999); Gillette, *supra* note 20, at 493-94; Walter Hellerstein et al., *Commerce Clause Restraints on State Taxation After Jefferson Lines*, 51 TAX L. REV. 47, 50 (1995); Tatarowicz & Mims-Velarde, *supra* note 6, at 888-89.

136. Schoettle, *supra* note 135, at 283.

137. Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 483 U.S. 232, 259-60 (1987)

the foundation of the dormant Commerce Clause is the prohibition of economic protectionism.[138] The Court emphasized this in *New Energy*: "This 'negative' aspect of the Commerce Clause prohibits economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors."[139]

A. Within the Sixth Circuit

In the three major cases relied upon by the Sixth Circuit in deciding *Cuno* (*Boston Stock Exchange*, *Maryland v. Louisiana*, and *Westinghouse Electric Corp.*), the Court addressed situations where preferential treatment was given to in-state businesses by imposing a higher tax, or lesser credit, on out-of-state goods or services.[140] Such was also the case in *Bacchus Imports, Ltd.*, to which the Sixth Circuit referred.[141] In each of those cases, an in-state economic interest was protected at the expense of an out-of-state business, resulting in an obvious dormant Commerce Clause issue. In *Boston Stock Exchange*, the legislative history actually confirmed that the purpose of the transfer tax was a protectionist measure.[142] Moreover, "then Governor Nelson Rockefeller confirmed that the

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(Scalia, J., dissenting in part).

138. *See* Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 270-73 (1984); *cf.* Hunt v. Wash. State Apple Adver. Comm'n, 432 U.S. 333, 352-53 (1977) (holding unconstitutional burdens placed on out-of-state apple producers in order to sell within the state); Dean Milk Co. v. City of Madison, Wis., 340 U.S. 349, 354 (1951) (holding unconstitutional a city ordinance that prohibited the sale of milk in the city unless it had been bottled within five miles of the city).

139. New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 273 (1988).

140. Westinghouse Elec. Corp. v. Tully, 466 U.S. 388, 393-94 (1984) (enacting a franchise tax credit based on gross receipts from products shipped from a regular place of business within the state); Maryland v. Louisiana, 451 U.S. 725, 756-58 (1981) (protecting Louisiana consumers of OCS gas by only applying a first-use tax to gas moving out of state); Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 319 (1977) (imposing a transfer tax on sale of securities which was higher if sold out-of-state rather than in-state).

141. *Bacchus Imports*, 468 U.S. at 265 (encouraging in-state commerce by allowing an excise tax exemption for fruit wine manufactured in Hawaii and for okolehao, a brandy distilled from the root of a shrub indigenous to Hawaii).

142. New York, since 1905, had imposed a transfer tax on securities transactions if part of the transaction occurred within the state. *Boston Stock Exch.*, 429 U.S. at 319. However, none of the states in which the appellant stock exchanges were located taxed the sale or transfer of securities. *Id.* at 323. In enacting the amendment to § 270, the legislature recognized that:

> [T]he tax on transfers of stock . . . is an important contributing element to the diversion of sales to other areas to the detriment of the economy of the state. . . . [Therefore], [i]n order to encourage the effecting by nonresidents of the state of New York of their sales within the state of New York and the retention within the state of New York of sales involving large blocks of stock, a separate classification of the tax on sales by nonresidents of the state of New York and a maximum tax for certain large block sales are desirable.

purpose of the new law was to 'provide long-term relief from some of the competitive pressures from outside the State."[143] As a result, transactions involving out-of-state sales were taxed more heavily than most transactions involving a sale within the state.[144] Likewise, in *Maryland v. Louisiana*, OCS gas was generally consumed in Louisiana without the burden of the first-use tax. Its principal application was to tax gas moving from Louisiana to out of state.[145]

Westinghouse Electric Corp. is most similar to *Cuno* because, like *Cuno*, it involved an income tax credit. However, unlike *Cuno*, the amount of the New York credit depended on both in-state and out-of-state activity. Since the ratio to calculate the credit was based on DISC gross receipts of export property shipped from within New York to total DISC gross receipts derived from the sale of all export property, the New York credit decreased as the percentage of exports outside New York increased.[146] The Court noted that *it was not the provision of the credit* that offended the Commerce Clause, "but the fact that it [was] allowed on an impermissible basis, i.e., the percentage of a specific segment of the corporation's business that [was] conducted in New York."[147] Thus, not only did the New York tax scheme provide a positive incentive for increased business activity in New York, but it also penalized increases in shipping activities in other states.[148] New York's intention, just as in *Boston Stock Exchange*, was to ensure that it did not lose its competitive position to other states, since other states would also be providing tax benefits to DISCs.[149] In doing so, it "violated the prohibition in *Boston Stock Exchange* against using discriminatory state taxes to burden commerce in other States in an attempt to induce 'business operations to be performed in the home State that could more efficiently be performed elsewhere.'"[150] Thus, the Court once again struck down a statute that had economic protectionism as its intention.

Each of those cases relied on by the Sixth Circuit can be distinguished from *Cuno*. First, the Ohio investment tax credit applied only to in-state activities. Like the export credit in *Westinghouse Electric Corp.*, as in-state activity increased (i.e., purchases of new machinery and equipment installed in-state), the Ohio investment tax credit increased as well; however, unlike *Westinghouse*, the credit did not decrease as out-of-state activity increased.[151] The Ohio credit was tied only to machinery and equipment purchases within the state. There was no

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Id. at 326-27 (quoting 1968 N.Y. Laws c. 827, § 1).

143. *Id.* at 327.

144. *Id.* at 319.

145. *Maryland v. Louisiana*, 451 U.S. at 759.

146. Westinghouse Elec. Corp. v. Tully, 466 U.S. 388, 400-01 n.9 (1984) (explaining how the credit was designed to increase as New York's share of the export activity increased and therefore would decrease as the business's other states' export activity increased).

147. *Id.* at 407 n.12.

148. *Id.* at 400-01.

149. *Id.* at 397.

150. *Id.* at 406 (quoting Pike v. Bruce Church, Inc., 397 U.S. 137, 145 (1970)).

151. *See* OHIO REV. CODE. ANN. § 5733.33(A)(8)-(13), (C)(1), (C)(2) (West 2004).

ratio of Ohio purchases of machinery and equipment to total purchases of machinery and equipment, as was the case in *Westinghouse*. This is a "crucial" distinction.[152] Hence, the Ohio investment tax credit provided a positive incentive for increased business activity in Ohio, but it did not penalize businesses that also increased their property presence in other states.[153]

Similarly, the Court noted in *Boston Stock Exchange* that the New York transfer tax created both "an advantage for the exchanges in New York and a discriminatory burden on commerce to its sister states."[154] If, as a result of the sale, the security was to be delivered or transferred to New York, the seller could not escape liability in New York by selling out-of-state, but the liability could be substantially reduced by selling in-state.[155] This seems to be similar to the investment tax credit in *Cuno*. An increase of manufacturing machinery and equipment located in Ohio yielded a credit from the state's franchise tax, resulting in a lower tax,[156] but that is where the similarities end. In *Boston Stock Exchange*, once a decision was made to sell a security with a portion of the transaction occurring in New York, the taxpayer was subject to the New York tax. However, if the sale took place out-of-state, the New York tax was higher. Thus, the amount of the New York tax depended on whether a portion of the transaction occurred out-of-state. There is no corresponding out-of-state transaction related to the Ohio investment tax credit.

Finally, in *Maryland v. Louisiana*, the net effect of the first-use tax, generally, was that Louisiana consumers of OCS gas were not burdened by the tax, but the tax did apply to competitive users in other states.[157] Specifically, as compared to *Cuno*, an owner paying the first-use tax on OCS gas received an equivalent tax credit on any state severance tax owed in connection with the extraction of natural resources within the state.[158] The Court noted that "[t]he obvious economic effect of this Severance Tax Credit [was] to encourage natural gas owners involved in the production of OCS gas to invest in mineral exploration and development within Louisiana rather than to invest in further OCS development or in production in other States."[159]

Again, this seems similar to the investment tax credit in Ohio. By purchasing new machinery and equipment and installing such machinery and equipment in Ohio, the state's franchise tax can be reduced by a percentage of the qualifying investments, thus providing an incentive for further investment in Ohio rather than investing in other states. Yet the distinction here is that the Louisiana credit

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152. Cuno v. DaimlerChrysler, Inc., 154 F. Supp. 2d 1196, 1203 (N.D. Ohio 2001), *rev'd*, 386 F.3d 738 (6th Cir. 2004).

153. *See Westinghouse Elec. Corp.*, 466 U.S. at 400-01.

154. Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 331 (1977).

155. *Id.*

156. Cuno v. DaimlerChrysler, Inc., 386 F.3d 738, 741 (6th Cir. 2004), *cert. granted*, 73 U.S.L.W. 3751 (U.S. Sept. 27, 2005) (No. 04-1704).

157. Maryland v. Louisiana, 451 U.S. 725, 759 (1981).

158. *Id.* at 732.

159. *Id.* at 757.

went to a specific item resulting in a price differential to in-state and out-of-state taxpayers. As a result of the Louisiana Severance Tax Credit, the price of natural gas to in-state consumers was less than the same product used by out-of-state consumers. There is no similar product correlation related to the Ohio investment tax credit. Out-of-state taxpayers are not required to pay a higher tax on the same item used by an in-state taxpayer in Ohio as a result of the investment tax credit. Thus, out-of-state taxpayers are not burdened by the Ohio investment tax credit as were "purchasers of gas moving through Louisiana in interstate commerce."[160]

Thus, because Ohio's investment tax credit can be distinguished from each of the major cases relied on by the Sixth Circuit, the Supreme Court should conclude, as it has granted certiorari to the *Cuno* appellants' case, that a tax credit based on similar criteria as Ohio's does not discriminate against interstate commerce. Because Ohio's investment tax credit does not discriminatorily tax the products manufactured in another state or the business operations performed in any other state,[161] the Court should conclude that a state's investment tax credit which looks only to in-state operations is a permissible way for the state to structure its tax system to encourage the growth and development of intrastate commerce and industry.[162]

In the meantime, states in the Sixth Circuit—Kentucky, Michigan, Ohio, and Tennessee—are at a distinct disadvantage to states outside the Sixth Circuit which are not bound by the *Cuno* decision.[163] The *Toledo Business Journal* wrote:

> A number of major investment projects in northwest Ohio have been put either on hold or are being reexamined as a result of the Sixth Circuit US Court of Appeals' decision in *Cuno v. DaimlerChrysler* on September

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160. *Id.* at 760.

161. *See* Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336-37 (1977).

162. *See id.* at 336.

163. *See generally* Petition for Rehearing with Suggestion for Rehearing En Banc of Appellee, Cuno v. DaimlerChrysler, Inc., 386 F.3d. 738 (6th Cir. 2004) (No. 01-3960). The appellee noted that:

> [I]f the panel's reasoning is correct, hundreds of state statutes are at risk, the financial operations of thousands of businesses will be disrupted, and the economic planning of states and localities across the land will be thrown into disarray. Yet if other courts recognize the errors in the panel's reasoning, every state outside [the Sixth] Circuit will be free to compete for jobs and economic development with a powerful tool that the panel has taken away from Ohio, Kentucky, Michigan, and Tennessee.

Id. at 8; *see also* Brief of Amicus Curiae Mich. Econ. Dev. Corp. at 7-10, Cuno v. DaimlerChrysler, Inc., 386 F.3d. 738 (6th Cir. 2004) (No. 01-3960) (noting the "chilling" effect the court's decision is likely to have on economic development within Michigan and the negative impact on Michigan's ability to compete not only with other states but also internationally); Brief of Amici Curiae Michigan et al. at 6-7, Cuno v. DaimlerChrysler, Inc., 386 F.3d. 738 (6th Cir. 2004) (No. 01-3960) (noting the court's decision will undoubtedly have a chilling effect on capital development projects in all industries in Michigan, Kentucky, and Tennessee).

> 2[,] [2004]. These projects represent the retention of hundreds of existing area jobs and the opportunity to add hundreds of new high paying positions for residents of northwest Ohio. . . . In September, the Regional Growth Partnership was close to announcing a major project in the area. . . . [T]his project and its new jobs have been put on hold by the client as a result of the Sixth Circuit's ruling. The client is now looking at putting this project in Indiana, which is not affected by the Sixth Circuit's ruling.[164]

B. Even Within the Sixth Circuit, All Is Not Dead

Yet, even within the Sixth Circuit, not all economic development tax incentive measures are dead. The Sixth Circuit held that the Ohio personal property tax exemption did not violate the dormant Commerce Clause.[165] The court noted that the statute,[166] which requires an investment in new or existing property within an enterprise zone and the maintenance of employees, "does not impose specific monetary requirements, require the creation of new jobs, or encourage a beneficiary to engage in an additional form of commerce independent of newly acquired property."[167] The court identified the conditions noted as "minor collateral requirements . . . directly linked to the use of the exempted personal property."[168]

The reasoning for maintaining the constitutionality of Ohio's property tax exemption, however, seems to also support maintaining Ohio's investment tax credit. The court stated that "[a]lthough conditions imposed on property tax exemptions may independently violate the Commerce Clause, *conditional exemptions raise no constitutional issues when the conditions for obtaining the favorable tax treatment are related to the use or location of the property itself.*"[169] Ohio's investment tax credit was conditioned on the property being installed in Ohio. This was the plaintiffs' central argument and a consideration by the court in striking down the investment tax credit as discriminating against interstate commerce.[170]

However, the court went on to provide that "an exemption may be discriminatory if it requires the beneficiary to engage in another form of business in order to receive the benefit or *is limited to businesses with a specified*

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164. *Court Ruling Jeopardizes Ohio Projects*, *supra* note 5, at 1.

165. *Cuno*, 386 F.3d at 748.

166. OHIO REV. CODE ANN. § 5709.62(C)(1) (West 2004) (permitting municipalities to offer specified incentives to an enterprise that "agrees to establish, expand, renovate, or occupy a facility and hire new employees, or preserve employment opportunities for existing employees" in economically depressed areas).

167. *Cuno*, 386 F.3d at 747.

168. *Id.*

169. *Id.* at 746 (emphasis added).

170. *Id.* at 743.

economic presence."[171] Ohio's investment tax credit was limited to businesses with a "specified economic presence." Specifically, the court noted that section 5733.33(C)(1) provided: "The investment tax credit is generally 7.5 percent 'of the excess of the cost of the new manufacturing machinery and equipment purchased during the calendar year for use in a county over the county average new manufacturing machinery and equipment investment for that county.'"[172] Even so, the court concluded that "if the conditions imposed on the exemption do not discriminate based on an independent form of commerce, they are permissible."[173]

In its explanation, the court noted that there are fundamental differences between credits and exemptions: an investment tax credit reduces preexisting income tax liability, whereas a personal property exemption does not reduce any existing property tax liability.[174] Thus, as the court explained:

> [A] taxpayer's failure to locate new investments within Ohio simply means that the taxpayer is not subject to the state's property tax at all, and any discriminatory treatment between a company that invests in Ohio and one that invests out-of-state cannot be attributed to the Ohio tax regime or its failure to reduce current property taxes.[175]

The court also noted that "the personal property tax exemption is internally consistent because, if universally applied, the new property would escape tax liability irrespective of location. Every new investment, no matter where undertaken, would be exempt from a tax."[176] Would this not also be the case if every state provided an investment tax credit?

The court did not provide direct authority for its assertions in upholding Ohio's property tax exemption, but it did compare *Maryland v. Louisiana* as an example of an unconstitutional tax benefit.[177] The court did, however, refer to a law review article authored by Professors Hellerstein and Coenen who concluded that property tax incentives that offer an exemption or abatement for new investment in the state, without collateral requirements discrete from the use or location of the property itself, should survive constitutional scrutiny.[178] Professors Hellerstein and Coenen distinguished property tax exemptions from investment tax credits by providing first, that credits favor in-state activity by invariably confining the credit in-state and second, they implicate the coercive power of the state by allowing taxpayers to reduce their state tax only by

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171. *Id.* at 746 (emphasis added).

172. *Id.* at 741 (quoting OHIO REV. CODE ANN. § 5733.33(C)(1) (West 2004)).

173. *Cuno*, 386 F.3d at 747.

174. *Id.*

175. *Id.*

176. *Id.* at 748.

177. *Id.* at 746.

178. *Id.* at 747-48; *see also* Hellerstein & Coenen, *supra* note 126, at 825-29 (concluding that property tax exemptions for the most part survive constitutional scrutiny under their "in-state/state-coercion" approach).

engaging in in-state activity.[179] The distinguishing factors between the two, for Professors Hellerstein and Coenen, are that "[property tax incentives] do not favor in-state over out-of-state investment, if one assumes—as one ought to—that other states have adopted taxing regimes similar to the one in question."[180] Neither do property tax incentives implicate the "coercive power of the state" since a taxpayer does not reduce an otherwise existing in-state property tax liability by acquiring property in the state.[181]

Consequently, states within the Sixth Circuit, though not completely stripped of all tax incentives which can be offered, are much more limited than those states outside the Sixth Circuit. How will other income tax incentives fare based on the broad interpretation by the Sixth Circuit of tax incentives that burden interstate commerce?

IV. STATE TAX INCENTIVES—HERE TODAY . . . GONE TOMORROW?

Today every state provides tax incentives to induce industrial location and expansion.[182] "Indeed, scarcely a day goes by without some state offering yet another tax incentive to spur economic development, often in an effort to attract a particular enterprise to the state."[183] Yet, in light of the Sixth Circuit's decision in *Cuno*, how will these tax incentives fare under constitutional scrutiny? If the Supreme Court were to follow the holding of the Sixth Circuit Court of Appeals, virtually no state income tax credit, the most common form of state tax incentive in the country,[184] could meet the appeals court's broad requirement of strict geographic neutrality. Any investment tax credit, similar to Ohio's, that is based on in-state investment;[185] or any research and development credit based on in-state research activity;[186] or credits to business enterprises that increase in-state

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179. Hellerstein & Coenen, *supra* note 126, at 817.

180. *Id.* at 825.

181. *Id.*

182. Hellerstein, *supra* note 4, at 413.

183. *Id.*

184. Hellerstein & Coenen, *supra* note 126, at 817.

185. *See, e.g.*, CAL. REV. & TAX. CODE § 23649 (West 2005) (providing a credit equal to six percent of qualified property placed in service "in this state"); COLO. REV. STAT. § 39-22-507.6 (2004) (providing a credit for property "used" in-state); MASS. GEN. LAWS ch. 63, § 31A (2005) (providing investment tax credit for qualified property used in-state); N.J. STAT. ANN. § 54:10A-5.5, 5.6 (West 2004) (providing a credit for in-state investment in new or expanded facility); N.M. STAT. ANN. § 7-9A-5 (LexisNexis 2004) (providing an investment tax credit may be claimed by a qualifying taxpayer carrying on a manufacturing operation in-state); N.C. GEN STAT. § 105-129.9 (2004) (providing a credit for investing in machinery and equipment in-state).

186. *See, e.g.*, ARIZ. REV. STAT. ANN. § 43-1168 (2004) (providing tax credit for increased research activities in-state); N.J. STAT. ANN. § 54:10A-5.24 (West 2004) (providing tax credit for qualified research expenses for research conducted in-state); N.C. GEN. STAT. § 105-129.10 (2004) (providing a tax credit for in-state apportioned research expenses).

employment[187] would fail constitutional scrutiny.

A. Professors Hellerstein and Coenen vs. Professor Enrich

Professors Hellerstein and Coenen would agree with that result based on their in-state favoritism/state-coercion rationale. Under their test, state income tax credits fail to pass muster first, because they favor in-state over out-of-state activity since income tax credits are almost invariably confined to the former, and second, because they implicate the coercive power of the state since the taxpayer can reduce its state tax bill only by engaging in in-state activity.[188] In addition to invalidating income tax credits, their in-state favoritism/state-coercion rationale of analyzing state tax incentives would invalidate many, if not most, tax incentives.[189] Professors Hellerstein and Coenen characterized the state, in effect, as saying:

> You are already subject to our taxing power because you engage in taxable activity in this state. If you would like to reduce your tax burdens, you may do so by directing additional business activity into this state. Should you decline our invitation, we will continue to exert our taxing power over you as before, and your tax bill might even go up.[190]

Still, under the Hellerstein and Coenen approach, there is at least one category of tax incentives that should escape invalidation: tax incentives which are not exemptions from or reductions of an existing state tax liability but rather are exemptions from or reductions of an additional state tax liability to which the taxpayer would be subjected only if the taxpayer were to engage in the targeted activity in the state.[191] Results under this test, at least in some instances, would depend on whether the taxpayer had previously engaged in some taxable activity within the state.[192] In contrast to income tax incentives, Hellerstein and Coenen characterized the state's posture related to property tax exemptions as: "Come to our state and we will not saddle you with any additional property tax burdens. Moreover, should you choose not to accept our invitation, nothing will happen to your tax bill—at least nothing that depends on our taxing regime."[193] Therefore, based on their test, even though income tax credits would be invalid, property tax abatements based on new in-state investments or sales and use tax exemptions for the construction of new facilities in the state (unless tied to other

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187. *See, e.g.*, GA. CODE ANN. § 48-7-40 (2004) (providing a tax credit based on additional new jobs created in-state); *id.* § 48-7-40.5 (providing a tax credit for retraining of resident employees); N.C. GEN STAT. § 105-129.8 (2004) (providing a tax credit for creating new full-time jobs in-state); S.C. CODE ANN. § 12-6-3360 (2004) (providing a jobs tax credit to qualified employers based on location of job creation in-state).

188. Hellerstein & Coenen, *supra* note 126, at 817.

189. *Id.* at 806-07.

190. *Id.* at 808.

191. *Id.* at 807.

192. Schaefer, *supra* note 1, at 325.

193. Hellerstein & Coenen, *supra* note 126, at 808.

in-state activity such as job creation or a certain size of enterprise) would be "valid since the state is merely 'disclaiming the right to impose any taxes on a 'virgin' tax base the state is seeking to attract.'"[194]

Professor Enrich advocates that when analyzing the constitutionality of state location incentives for businesses, it is the antidiscrimination principle that is of primary significance.[195] Indeed, "the prohibition against state tax provisions that discriminate against interstate commerce has been a central tenet of the Court's Commerce Clause case law throughout its history. . . ."[196] Professor Enrich suggests, however, that instead of the in-state favoritism/state-coercion test advocated by Professors Hellerstein and Coenen, "the primary focus in determining whether a particular tax provision runs afoul of the antidiscrimination principle is a practically oriented analysis of the provision's purposes and effects."[197] Under the anti-discrimination principle, with the focus being on discrimination against out-of-state businesses or interests, "a property tax or sales tax abatement is unlikely to be struck down for out-of-state businesses are not responsible for these taxes and thus there can be no discrimination against these businesses."[198] In contrast, a state investment tax credit given only for in-state investment would likely be struck down since it discriminates against out-of-state business activity by requiring the business to conduct its business in-state in order to receive the credit.[199]

Professor Enrich argues, though, that Commerce Clause values are broader than merely discrimination against out-of-state interests.[200] He argues that the primary objective of the Commerce Clause is to create and preserve an open interstate economy, "a national common market."[201] He is concerned with distortions caused to the national economy, economic balkanization, and rivalries between the states.[202] He maintains that the focus in evaluating a tax incentive "should be whether a particular tax provision distorts economic decisionmaking in favor of in-state activity, not whether it treats in-state and out-of-state actors disparately."[203] Under this more restrictive approach (as compared to the Hellerstein/Coenen test), the property tax abatement would be treated the same as an investment tax credit: both would be illegal.[204]

Professor Enrich offers that the Court has the opportunity to strengthen and clarify its Commerce Clause jurisprudence by reframing the antidiscrimination

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194. Schaefer, *supra* note 1, at 325 (quoting Hellerstein & Coenen, *supra* note 126, at 809).

195. Enrich, *supra* note 2, at 426.

196. *Id.*

197. *Id.* at 432.

198. Schaefer, *supra* note 1, at 325.

199. *Id.*

200. Enrich, *supra* note 2, at 453.

201. *Id.* at 454 (quoting Hunt v. Wash. State Apple Adver. Comm'n, 432 U.S. 333, 350 (1977)).

202. *Id.* at 454-55.

203. *Id.* at 456.

204. Schaefer, *supra* note 1, at 326.

principle, specifically, by "prohibit[ing] state tax measures that discriminate against interstate commerce by distorting the decisions of economic actors in favor of expenditures on in-state activities."[205] Under this reframed antidiscrimination principle, economic development "location incentives would be virtually per se unconstitutional."[206] These incentives "would be condemned, not because they commonly have the effect of placing out-of-state activities at a relative disadvantage, nor because they typically distinguish on their face between in-state and out-of-state activity, but because their central function is to influence economic location decisions and to divert investment into the state."[207]

The Sixth Circuit, by upholding Ohio's property tax exemption in *Cuno*, clearly rejected Professor Enrich's more restrictive approach of analyzing location tax incentives.[208] Instead, the holding followed the logic of Hellerstein and Coenen's in-state favoritism/state-coercion rationale.[209] Even this rationale, though, is much too broad based on Supreme Court Commerce Clause precedent. It seems, that based on the Court's own reasoning, the test should be who bears the burden? In other words, who pays the price to "lure" the new business, or expansion of an existing business, in-state? Is this cost borne generally by citizens in-state who have their own competing demands, or is the cost borne by firms out-of-state that have chosen a lesser economic presence?

B. One More Look at Subsidies

The defendants in *Cuno*, alternatively, likened the Ohio investment tax credit to a direct subsidy. The Sixth Circuit, however, quickly dismissed that argument citing *New Energy Co. of Indiana* and *West Lynn Creamery*.[210] The appeals court noted that the distinction, in the constitutional sense, between a subsidy and a tax credit results from the fact that the tax credit involves state regulation of interstate commerce through its power to tax.[211] The Court, however, has acknowledged in *Camps Newfound/Owatonna, Inc. v. Town of Harrison*[212] that "tax exemptions and subsidies serve similar ends."[213]

Even so, holdings of the Court have rested on the premise that "there is a constitutionally significant difference between subsidies and tax exemptions."[214]

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205. Enrich, *supra* note 2, at 457-58.

206. *Id.* at 458.

207. *Id.*

208. *See* Cuno v. DaimlerChrysler, Inc., 386 F.3d 738, 748 (6th Cir. 2004), *cert. granted*, 73 U.S.L.W. 3751 (U.S. Sept. 27, 2005) (No. 04-1704); *see also id.* at 740 (noting that Professor Enrich served as counsel for plaintiffs in *Cuno*).

209. *Id.* at 747.

210. *Id.* at 746.

211. *Id.*

212. 520 U.S. 564 (1997).

213. *Id.* at 589.

214. *Id.* at 590; *see also* Walz v. Tax Comm'n of New York, 397 U.S. 664, 673 (1970) (holding that New York's tax exemption for church property did not violate the Establishment

The taxpayer in *Camps Newfound/Owatonna* was a nonprofit corporation in Maine that operated a summer camp for the benefit of children of the Christian Science faith.[215] Because the camp predominately served nonresidents, the relevant Maine statute[216] denied the camp an exemption from local real estate taxes, even though an otherwise identical camp serving in-state residents would be exempt from local real estate taxes.[217] The Court concluded that it was not necessary to look beyond the text of the statue to determine that it discriminated against interstate commerce.[218] Even though the statute was determined to be *per se* discriminatory, the Town argued, among other things, that the statute should be viewed as a legitimate discriminatory subsidy to those charities that choose to focus their activities on local concerns. Since a direct subsidy would pass constitutional muster,[219] the Town argued that exemption statute should satisfy Commerce Clause requirements as well.[220] The Court disagreed, though Professor Zelinsky commented, "in a fashion that is not wholly convincing."[221] The *Camps Newfound/Owatonna* decision is significant, not only because the Court reiterated that it has not squarely confronted the constitutionality of subsidies, but also because the majority along with the dissenters "underscored the untenability" of the tax/subsidy distinction.[222]

The majority cited *Walz* for the proposition "that there is a constitutionally significant difference between subsidies and tax exemptions"[223] However, just prior to its invocation of *Walz*, the *Camps Newfound/Owatonna* Court noted, "somewhat confusingly,"[224] that "[w]e recognized long ago that a tax exemption can be viewed as a form of government spending."[225] "At best, this observation required an explanation as to when conventional expenditures are (and are not)

Clause of the First Amendment, relying, in part, on the premise that there is a constitutionally significant difference between subsidies and tax exemptions).

215. *Camps Newfound/Owatonna, Inc.*, 520 U.S. at 567.

216. ME. REV. STAT. ANN., tit. 36, § 652(1)(A) (1996).

217. *Camps Newfound/Owatonna, Inc.*, 520 U.S. at 569; *see* Edward A. Zelinsky, *Are Tax "Benefits" Constitutionally Equivalent to Direct Expenditures?*, 112 HARV. L. REV. 379, 387 (1998) [hereinafter Zelinsky, *Tax Benefits*].

218. *Camps Newfound/Owatonna, Inc.*, 520 U.S. at 575-76.

219. Even though the Town argued that a direct subsidy is constitutional, the Court did not reach the question whether the hypothesized subsidy would survive constitutional challenge. Instead, it explicitly noted that the issue of subsidies was not before it and need not be addressed today. Indeed, the Court merely "[a]ssum[ed], *arguendo*, that the Town [was] correct that a direct subsidy benefiting only those nonprofits serving principally Maine residents would be permissible . . . ." *Id.* at 589.

220. *Id.* at 588-89.

221. Zelinsky, *Tax Benefits*, *supra* note 217, at 387.

222. Zelinsky, *Restoring Politics to the Commerce Clause*, *supra* note 135, at 43.

223. *Camps Newfound/Owatonna, Inc.*, 520 U.S. at 590; *see* Zelinsky, *Tax Benefits*, *supra* note 217, at 387.

224. Zelinsky, *Tax Benefits*, *supra* note 217, at 387.

225. *Camps Newfound/Owatonna, Inc.*, 520 U.S. at 589 n.22.

equivalent to tax benefits—an explanation that the Court did not provide; at worst, this observation contradicted the Court's simultaneous, *Walz*-based assertion that tax benefits and direct spending are different."[226] Furthermore, the Court never articulated its rationale for rejecting the Town's claim.[227] It did, however, reiterate its oft-quoted statement from *West Lynn Creamery* that "[w]e have 'never squarely confronted the constitutionality of subsidies,' and we need not address these questions today."[228]

The *Camps Newfound/Owatonna* decision is significant for another reason: the dissenting justices underscored the problems of the Court's dormant Commerce Clause case law.[229] Justice Scalia, also writing for Chief Justice Rehnquist and Justices Thomas and Ginsburg, began by noting:

> The Court's negative Commerce Clause jurisprudence has drifted far from its moorings. . . . Our cases have struggled (to put it nicely) to develop a set of rules by which we may preserve a national market without needlessly intruding upon the States' police powers, each exercise of which no doubt has some effect on the commerce of the Nation.[230]

Even though Justice Scalia declared, just as he had done in *New Energy Co. of Indiana*, that "direct subsidies to domestic industry do not run afoul of the Commerce Clause[,]"[231] he equated state social services provided only to residents to tax exemptions limited to in-state charities.[232] In Justice Scalia's view:

> [T]he provision by a State of free public schooling, public assistance, and other forms of social welfare to only (or principally) its own residents—whether it be accomplished *directly or by providing tax exemptions, cash, or other property* to private organizations that perform the work for the State—implicates none of the concerns underlying our negative Commerce Clause jurisprudence.[233]

Justice Thomas, writing for himself and Justice Scalia, declared that Maine's tax exemption for certain charities was "in truth, no different than a subsidy paid out of the State's general revenues."[234] He explained that he wrote separately

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226. Zelinsky, *Tax Benefits*, *supra* note 217, at 387.

227. *Id.* at 388.

228. *Camps Newfound/Owatonna, Inc.*, 520 U.S. at 589 (quoting West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 199 n.15 (1994)).

229. Zelinsky, *Restoring Politics to the Commerce Clause*, *supra* note 135, at 43.

230. *Camps Newfound/Owatonna, Inc.*, 520 U.S. at 595-96 (Scalia, J., dissenting).

231. *Id.* at 597; *see also* New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278 (1988) (noting direct subsidization of domestic industry does not ordinarily run afoul of the negative Commerce Clause).

232. *Camps Newfound/Owatonna, Inc.*, 520 U.S. at 605-06 (Scalia, J., dissenting).

233. *Id.* at 607-08 (emphasis added).

234. *Id.* at 640 (Thomas, J., dissenting).

because he believed that the Court's expansion of the negative Commerce Clause in *Camps Newfound/Owatonna* was possible only because the Court's "negative Commerce Clause jurisprudence . . . was already both overbroad and unnecessary. . . . That the expansion effected by today's decision finds some support in the morass of our negative Commerce Clause case law only serves to highlight the need to abandon that failed jurisprudence . . . ."[235]

Significantly, not only were Justice Scalia and Justice Thomas asserting the similarities between a tax exemption and a subsidy, they were also advocating abandoning the dormant Commerce Clause jurisprudence altogether. Professor Zelinsky notes that the Justices' desire to abandon the dormant Commerce Clause may explain why they cling to the tax/subsidy distinction despite its logical flaws: if they cannot convince their colleagues to abandon the dormant Commerce Clause, then it tactically makes sense to cabin that Clause as much as possible.[236]

West Lynn Creamery, Inc. v. Healy[237] has been the most recent subsidy case heard by the Court. It involved a Massachusetts pricing order that imposed an assessment on the sale of all fluid milk by dealers to Massachusetts retailers. These payments were placed into a fund that was distributed solely to Massachusetts dairy farmers; however, two-thirds of the milk was produced out-of-state. Even though the subsidy was struck down, it was invalidated "on very narrow grounds."[238] The Court noted that a pure subsidy funded from general revenues ordinarily imposes no burden on interstate commerce, but merely assists local business.[239] The Massachusetts pricing order, however, was funded principally from taxes on the sale of milk produced in other states.[240] The Court explained that by funding the subsidy in that manner, the state "not only assist[ed] local farmers, but burden[ed] interstate commerce. The pricing order thus violate[d] the cardinal principle that a State may not 'benefit in-state economic interests by burdening out-of-state competitors."[241]

Even though Justice Scalia, joined by Justice Thomas, concurred in the judgment, he rejected a distinction between subsidies and tax exemptions, concluding that subsidies, whether in the "form of cash" or "tax forgiveness" ultimately "come[] to the same thing."[242] Chief Justice Rehnquist, as did Justice Scalia, rejected the majority's argument that by coupling the tax with the subsidy, those who would have otherwise lobbied against the tax were instead "mollified by the subsidy."[243] The Chief Justice dissented, arguing that the tax and the

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235. *Id.* at 610.

236. Zelinsky, *Restoring Politics to the Commerce Clause*, *supra* note 135, at 46.

237. 512 U.S. 186 (1994).

238. Petrov, *supra* note 20, at 99; *see also West Lynn Creamery, Inc.*, 512 U.S. at 199.

239. *West Lynn Creamery, Inc.*, 512 U.S. at 199.

240. *Id.*

241. *Id.* (quoting New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 273-74 (1988)).

242. *Id.* at 208-09 (Scalia, J., concurring).

243. *Id.* at 214 (Rehnquist, C.J., dissenting); *see id.* at 212 (Scalia, J., concurring) (stating: "as THE CHIEF JUSTICE explains, '[a]nalysis of interest group participation in the political process

subsidy should have been evaluated independently.[244]

These two cases alone show the division of the Court related to the distinction between tax exemptions and subsidies. What is surprising, though, after analyzing the two cases is the conclusion reached by Justice Scalia in *New Energy Co. of Indiana*. *New Energy Co.* exemplifies the inequity of finding a distinction between exemptions and subsidies, of looking at "formal language" rather than the "economic realities."[245] *New Energy Co.* involved an Ohio tax credit designed to encourage the in-state production of ethanol. Ohio allowed a tax credit against the state's motor fuel tax for each gallon of ethanol sold by fuel dealers, but only if the ethanol was produced in Ohio or in a state that granted similar tax advantages to ethanol produced in Ohio.[246] The appellant was an Indiana manufacturer of ethanol. Indiana had repealed its tax exemption for ethanol and in its stead passed legislation providing a direct subsidy to Indiana ethanol producers. Thus, by reason of Ohio's reciprocity provision, appellant's ethanol sold in Ohio was ineligible for Ohio's tax credit.[247] Invoking the nondiscrimination principle, the Court concluded that the provision "explicitly deprive[d] certain products of generally available beneficial tax treatment because they [were] made in certain other States, and thus on its face appear[ed] to violate the cardinal requirement of nondiscrimination."[248]

Justice Scalia, writing for a unanimous Court, interestingly did find in *New Energy Co.* a distinction between a tax exemption and a subsidy, nonetheless noting that the subsidy was no less discriminatory than the tax credit being attacked.[249] Between 1988 when, *New Energy Co.* was decided, 1994, when *West Lynn Creamery* was decided, and 1997, when *Camps Newfound/Owatonna* was

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may serve many useful purposes, but serving as a basis for interpreting the dormant Commerce Clause is not one of them'").

244. *Id.* at 214-16 (Rehnquist, C.J., dissenting).

245. *See* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (noting for Commerce Clause purposes, it is "not the formal language of the tax statute but rather its practical effect" that should control).

246. *See* OHIO REV. CODE ANN. § 5735.145(B) (West 1986).

247. New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 272-73 (1988).

248. *Id.* at 274.

249. *Id.* at 278. Noting the distinction, the Court provided:

> It has not escaped our notice that the appellant here, which is eligible to receive a cash subsidy under Indiana's program for in-state ethanol producers, is the potential beneficiary of a scheme no less discriminatory than the one that it attacks, and no less effective in conferring a commercial advantage over out-of-state competitors. To believe the Indiana scheme is valid, however, is not to believe that the Ohio scheme must be valid as well. The Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description *in connection with the States regulation of interstate commerce.* Direct subsidization of domestic industry does not ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufacturers does.

Id. (emphasis added).

decided, the Court became divided on the issue of whether or not there is a distinction between tax exemptions and subsidies. Even with this division, it seems the Court would find a subsidy funded from the state's general treasury constitutional and would find unconstitutional a specific tax imposed predominately on out-of-state tax taxpayers. At this juncture, however, the Court majority has not equated a tax exemption and a direct subsidy. Thus, notwithstanding the lack of explanation, the Sixth Circuit, in dismissing the argument of the *Cuno* plaintiffs that Ohio's investment tax credit was like a direct subsidy, did follow Supreme Court precedent.

Nonetheless, based on the reasoning of *West Lynn Creamery*, it follows that states that fund tax exemptions and credits from an economic development fund which is funded by the general assembly should pass constitutional scrutiny.[250] Assuming, as the Court did in *West Lynn Creamery*, that both Massachusetts's exemption and subsidy standing alone would have been constitutional, the pricing order was nevertheless struck down because the subsidy was funded principally from taxes on the sale of milk produced out-of-state rather than from the state's general revenue.[251] For the states that have created economic development funds, in-state interests can lobby against the appropriations for economic development if they so desire.[252] In this manner, the state's political processes can be relied upon "to prevent legislative abuse."[253]

CONCLUSION

The Sixth Circuit has placed a very heavy burden on the states within its jurisdiction. Those states—Kentucky, Michigan, Ohio, and Tennessee—are no longer on the same economic development playing field with the rest of the nation. When the Supreme Court addresses the issue of economic development tax incentives in its review of *Cuno v. DaimlerChrysler*, it need not even get to the issue of whether the tax incentive is similar to a subsidy. The Court should look to who is bearing the burden. In other words, who pays the price to "lure" the new business, or expansion of an existing business, in-state? Is this cost borne generally by citizens in-state who have their own competing demands, or is the cost borne by out-of-state competitors? The analysis of Justice Brickley in *Caterpillar, Inc.* provides a guide: "Basing a deduction on a change in a

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250. *See* COLO. REV. STAT. ANN. § 24-46-105 (West 2004) (creating Colorado economic development fund subject to annual appropriation by the general assembly); 35 ILL. COMP. STAT. 10/5-85 (2004) (funding tax credit awarded to taxpayer meeting economic development criteria from "Economic Development for a Growing Economy Fund" which is funded in part from appropriations from the general assembly); IND. CODE § 6-3.1-13-26 (2004) (funding tax credit awarded to taxpayer meeting economic development criteria from "economic development for a growing economy fund" which is funded in part from appropriations from the general assembly); *cf.* 12 PA. CONS. STAT. ANN. § 3706(c) (West 2004) (providing limitation of $25 million for approved tax credits).

251. West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 199 (1994).

252. *See id.* at 200.

253. *Id.*

subset of a company's in-state activity relative to its total activity is unconstitutional."[254] In that situation, just as in *Westinghouse Electric Corp.*, out-of-state competitors do bear the burden of "economic protectionism." However, where the incentive is available equally to in-state and out-of-state businesses, without reference to a subset of the company's activities, the incentive should pass constitutional scrutiny. Likewise, states that fund their economic development tax credits and exemptions from general revenue appropriations should also pass constitutional scrutiny.

Nevertheless, the holding by the Sixth Circuit invalidating Ohio's investment tax credit misapplied previous Supreme Court precedent. It failed to recognize crucial distinctions. As a result, the broad holding of the Sixth Circuit would invalidate virtually every income tax credit or deduction provided as an economic development incentive. A decision of a business to expand in-state or to locate within a state necessarily is a benefit to one state and a detriment to all others.[255] Yet, that should not be the basis to nullify incentives provided throughout this country. States, businesses, communities, and individuals have relied on development incentives and have planned accordingly.[256]

Arguably, "competition among the states in the form of development incentives was a concern for the drafters of the Constitution in vesting the federal government with the commerce power."[257] Writing on commercial competition as a source of contention among the states in *The Federalist*, Alexander Hamilton "expressed particular worry about states adopting commercial policies peculiar to themselves, creating 'distinctions, preferences, and exclusions, which would beget discontent.'"[258] Yet, Alexander Hamilton, even with his concerns regarding commercial competition, was granted a tax abatement in 1791 by the state of New Jersey to start a business.[259]

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254. Caterpillar, Inc. v. Dep't of Treasury, 488 N.W.2d 182, 216 (Mich. 1992) (Brickley, J., dissenting in part).

255. *See* The State of Ohio's Petition for Rehearing, Cuno v. DaimlerChrysler, Inc., 386 F.3d 738 (6th Cir. 2004) (No. 01-3960) (noting that *any* growth in one state comes at the expense of development in other states).

256. Brief of Amici Curiae Louisville Area Chamber of Commerce, Inc. et al. at 7, Cuno v. DaimlerChrysler, Inc., 386 F.3d 738 (6th Cir. 2004) (No. 01-3960) (citing Quill Corp. v. North Dakota, 504 U.S. 298, 317 (1992), which "declin[ed] to reverse a longstanding position on the states' methods of taxing mail order businesses because existing precedents had 'engendered substantial reliance and [had] become part of the basic framework of a sizable industry'").

257. Ivan C. Dale, Comment, *Economic Development Incentives, Accountability Legislation and a Double Negative Commerce Clause*, 46 ST. LOUIS U. L.J. 247, 272 (2002).

258. *Id.* (quoting THE FEDERALIST No. 7, at 29 (Alexander Hamilton) (Bantam Classic ed., 1982)).

259. *Id.*